ANNUAL REVIEW OF CORPORATIONS LAW

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General overview

The year 2016 has proven to be a frustrating year for persons interested in corporate law and related matters in Australia. Significant amendments to the legislation (the *Corporations Act 2001* (Cth) (the Act)), significant reforms to our insolvency law (the *Insolvency Law Reform Act 2016* (Cth)), corresponding amendments made to the administration of the Australian Securities and Investments Commission (ASIC), and other related matters that were promised during 2016 as a result of reports presented at the end of 2015 and earlier this year, were delayed. The calling of the Federal election in the middle of the year meant a delay in parliamentary sittings. As this review is being written, we have yet to see any significant statutory reforms other than the *Corporations Amendment (Crowd-sourced Funding) Bill 2016* (Cth), which will put into place proposed amendments dealing with this area of the law which were the subject of detailed reviews in previous years.

The proposed introduction of a possible "safe harbour" protection for directors trying to rescue corporations, contained in the Productivity Commission Report "Business Set-up, Transfer and Closure" (the Business Set-up Report) (presented to the Federal government in September 2015 but not acted upon until 2016), remains the most critical and important area for possible reform. Submissions have been called for from the public on the reaction of Treasury to the very comprehensive report; discussion papers have also been released. As a result, significant debate has occurred in the community in relation to the proposals. These are still currently being considered publicly by Treasury, as well as by the States, which need to cooperate with the Commonwealth in progressing any amendments to the corporations legislation.

The recommendations of the Murray Report into the Australian Financial Systems (the Murray Report) was presented to the Federal Government in 2015 and contained what many regarded as groundbreaking suggestions for law reform in a number of areas that still remain under close discussion by the government. The government has indicated that it will amend aspects of the current corporations legislation to deal with the recommendations of the Murray Report. However, the promise of discussion drafts and possible draft legislation for review by the public (made in 2015) has yet to be translated into firm action, other than announcements made by the Minister in the second last week of December 2016 (see later in this review). It will obviously be some time before we see the results of these considerations, although significant increases in funding have been made available to ASIC as a result of the developments (see below).

Another of the major developments during the course of 2016 was the government response to the ASIC Capability Report (the Capability Report), prepared by a small committee under the chairmanship of Karen Chester of the Productivity Commission. This was presented to the government in December 2015, but not released until April 2016. The Capability Report contained many significant recommendations. In particular it was very critical of aspects of the way in which ASIC operated, especially its enforcement strategy. The reaction by the government to the report so far has been to vote on additional funding for ASIC, primarily to assist it in dealing with alleged problems arising out of the operations of banks and financial institutions. More initiatives were foreshadowed in statements made in the last weeks of December. We comment briefly on these matters later in this review. Additional funding is likely to be provided to ASIC in due course.

We are particularly interested in the criticism made in the Capability Report that ASIC was unwilling to take "on board" difficult pieces of legislation which challenged particular problem areas that may have been uncovered by ASIC and its administration of the law. This failure on the part of ASIC to be more creative in its litigation strategy has led to an unsatisfactory reliance, in our respectful view, on the use of infringement notices in dealing with potential breaches of the law. This rather uninspiring approach to enforcement issues means that ASIC continues to rely on broad statements made to the media about its view concerning the appropriate "culture" and behaviour of company directors. Indeed, the emphasis on the lack of an appropriate "culture" on the part of ASIC has been a significant feature of its administration of the law during 2016. We will comment on this as well in more detail in the body of this review.

Nevertheless, it is fair to say that ASIC has in fact adopted a more active enforcement policy in the last few months. Many important challenges have been brought in the courts against persons in control of companies, although no really high profile litigation has been undertaken by ASIC, other than three cases against three of the major trading banks in relation to alleged market rigging allegations. These pieces of litigation will take a considerable amount of time to work their way through the system, which may not be the result that ASIC would like to see.

As noted earlier, one of the most unfortunate developments during 2016 has been the over-emphasis in the discussion by ASIC and its commissioners on the concept of "culture". There is little doubt that culture is a vital aspect in the way in which businesses in this country should be conducted. The *Commonwealth Criminal Code* (the Code), only became law in 2001 (although the legislation was enacted in 1995). This makes it essential for businesses, acting through corporations, partnerships, or other organisations or individuals, to ensure that they have in place an appropriate culture of compliance that recognises the need for companies not only to follow the law as set out in the Act but also in a range of other legislation.

The fact that parliament has, in the past, sought to incorporate into legislative policy their use of strict liability and reversal of the onus of proof mechanisms to strengthen ASIC's ability to regulate in this area, has been an unfortunate development. We will not comment further on it in the body of this overview. Suffice to say, the critical judgment of the recently retired Chief Justice of the High Court, Justice French, when a member of the Federal Court of Australia in 2005, in *Re Chemeq Ltd* ([2006] FCA 936), even though by way of obiter dicta, emphasised the importance of companies and other organisations subject to Commonwealth law embracing a "culture of compliance" and continually reviewing and updating the programs in place on a regular basis. This is a most important direction, in our view, to the business community.

This approach, in our opinion, places a very high priority on the right "culture" being in place. But, as a Federal Court judge recently suggested at the Federal Court of Australia/Law Council of Australia Corporate Law Conference in August 2016, which Bob Baxt attended, it is time for ASIC to stop talking about culture and to bring an appropriate case in which it challenges the alleged breach of culture (amounting to a breach of the law) that has allegedly occurred, to test the validity of its claims that directors sometimes do not embrace the appropriate culture in the management of companies.

As indicated earlier, in the past year ASIC has become more aggressive in its enforcement policy. There has also been a significant amount of private litigation. Our courts have been kept very busy during the year and there have been some very significant judgments dealing with the various issues of corporate law. In particular, the courts have been pressed to consider a number of interesting cases examining the ability of directors to exercise appropriate care and diligence in the management of companies that seek funds from the public, that engage in unusual lending activities through managed investment schemes and related operations, and to more traditional areas of the law. The cases throw up many examples of directors who have failed to comply with basic and fundamental rules to act with care and diligence, but also probably breach the duty to avoid conflict of interest duties. Insolvency issues intervene significantly in the work of directors and our courts have remained fairly rigid in their attitude towards the evaluation of insolvent trading and related matters. Of particular interest to us is the unwillingness of judges to provide any kind of relief to directors under ss 1317S and 1318 of the Act where the directors, in most cases, have been acting honestly and reasonably, but the courts do not have the willingness to forgive them for the breaches as is foreshadowed by the two provisions. ASIC was, however, disappointed in the result it obtained in the Victorian Supreme Court in late December in prosecutions against directors of the Australian Wheat Board: *Australian Securities and Investments Commission v Flugge and Geary* [2016] VSC 779. ASIC was however successful in one civil action against Mr Flugge and is seeking civil penalties.

ASIC has also suffered a negative result in the case of *Australian Securities and Investments Commission v Peter Drake* [2016] FCA 1024.

On 23 December 2016, Edelman J delivered a strong critique of the way ASIC had conducted its case against the directors of LM Investment Management, Peter Charles Drake, Francene Maree Mulder and Eghard van der Hoven. All charges were dismissed. The report on this decision could not be reviewed before this publication went to press.

The increase in litigation funding, especially in the class action debates that have continued to arise in our courts, have led to a number of fascinating decisions, and the courts have started to be a little more willing to allow the introduction of the USA-style concepts into our cases, such as that of "fraud on the market". Our courts are taking a greater interest in the way in which class actions are run and in particular the role of the litigation funder where there are different classes of litigants involved. The courts want to see fairness in the recovery of damages in these cases.

In this overview we once again discuss a number of cases setting up the remedies available to shareholders (and members), as well as other interested parties. This includes the consideration of statutory derivative action, oppression, issues arising out of class actions, and ancillary cases.

We will next comment on initiatives for reform which have been developed from different reports from ASIC, as well as from other bodies. The most critical areas considered in these relate to the importance of providing remedies to shareholders and investors in appropriate cases.

Legislative initiatives

As noted in above, 2016 has been a quiet year insofar as parliamentary action is concerned in the area of corporate law. Whilst the 2015 Murray Report has promised much in the context of government responses, there has been little, if any, statutory action taken to date.

There have been relatively few bills presented to parliament for consideration. At the very end of the year, the long awaited Crowd-sourced Funding legislation was introduced. The *Corporations Amendment (Crowd-sourced Funding) Bill 2016* (Cth) (the Bill) is virtually a mirror-image of the earlier bill presented in 2015 (see Annual Corporations Review 2015, page 10). This legislation is aimed at "opening up new and innovative sources of capital funding for Australian small businesses and start-ups – [being] a key driver of growth and jobs". The second reading speech by the Honourable Mr Scott Morrison noted that the legislation will allow businesses to "obtain capital from a large number of investors through an online platform, where each investor typically contributes a small amount of money in return for an equity stake in the business". The Bill is based on a 2014 review by the now defunct Corporations and Markets Advisory Committee (CAMAC), which recommended the introduction of such legislation, arguing that this would overcome the burden of the costs and impracticality imposed particularly on small businesses in seeking funding from the public.

In his second reading speech speech, Mr Morrison noted that the ability to raise the base funds of $5 million (with a maximum of $25 million in both assets and annual amounts), is seen as an important benchmark for small business. The government promises to review this threshold once the novation has been in operation for a few years.

Mr Morrison added that public companies would be eligible to use crowd-sourced equity funding. He has instructed Treasury to continue developing a framework for proprietary companies to take advantage of this initiative, where he expects that an extension of the framework will be introduced in the not too distant future.

One of the features of the crowd-sourced funding legislation is the recognition that disclosure is costly. As a result, the mechanisms to control disclosure in the proposed legislation are structured in order to minimise the disclosure requirements, whilst nevertheless ensuring that investors are protected. Under the announced framework, retailer investors will be able to invest up to $10,000 per investment issue within a 12 month period, providing the opportunity for investors to spread their risk across different initiatives. The legislation will provide a mechanism to ensure appropriate regulations may be made to enable appropriate amendments to be introduced to enable the legislation to work more effectively. Retail investors will not be limited in the total amount of investment in any particular funding that they undertake, as the Bill aims at diversification being a central feature. However, the Bill introduces an important cooling off period of 48 hours to be available to investors in accepting investing opportunities in this context.

We have not had the opportunity to examine the full implications of the legislation. However, in the reading speeches and related publicity, the government has highlighted the importance of intermediaries operating in the equity crowd-funding market. They are expected to act as gate keepers to provide an important quality assurance role in the creation and development of this initiative. The legislation sets out a number of obligations that intermediaries will need to comply with. Importantly, the intermediaries will be licensed and will be required to provide issuers and investors with confidence in the integrity of the relevant market, which includes ensuring that proper checks are made on issuers before they are allowed to offer their securities. Amendments to Chapter 7 of the Act will be introduced as a result of this Bill, which will enable the Australian market licensing regime to tailor the operations of the intermediaries in the relevant market. The ability to exempt certain activities will be given to the relevant Minister (the Treasurer) to ensure that the efficiency of the market can be maintained in light of this new initiative. Hopefully, this will also enable the government to reduce the compliance burden on various participants in the market as the operation of the Bill matures. The legislation will be debated in the 2017 parliamentary year and should come into operation quite early in the same year.

Whilst it was anticipated that the important changes would be made in 2016 in the context of director safeguards in trying to rescue companies, the government has not yet settled on how it would respond to the Business Set-up Report (referred to above). This report presented to the government in September 2015, but not made public until later, contains some significant amendments to the regulatory framework where companies face financial difficulties. The relevant proposals from the Productivity Commission have now been reduced to a set of draft initiatives which will be taken to parliament in 2017. The main aim here is to minimise the continued impact of the insolvent trading provisions of the act (namely s 588G) on the actions of directors who try to rescue companies.

The Business Set-up Report is in line with other initiatives taken by the government, especially in the area of insolvency law. In the Treasury discussion paper, "Improving Bankruptcy and Insolvency Laws", released in 2016, the Treasury announced its reaction to the Business Set-up Report and highlighted the need to prevent a continuation of policy which stigmatises business failure.

Because the legislation is not yet available for discussion, we are setting out in outline here the two alternatives put forward in the treasury consultation paper responding to the Business Set-up Report. Two models – Model A and Model B – were set out. They involve similar factors in evaluating how the government should proceed. If model A is adopted, directors would no longer be in fear of breaching the insolvent trading provisions if they had made a conscious decision to adopt a "safe harbour" advisor with a view to constructing a plan to rescue the company. The advisor, a person who is appropriately registered and has at least 5 years' experience, would be presented with all the books and records of the company to certify the company's financial position. In addition, the directors would need to demonstrate that they took all reasonable steps in pursuing the restructuring, as well as ensuring that the advice given was relevant to the company's circumstances at the time. In meeting the aforementioned requirements of this model, liability would not be imposed on the directors or the advisors in an attempt to save the company.

The alternative model, Model B, would provide a carve-out to the operation of the current insolvent trading provisions contained in ss 588G and 588H of the Act. The relevant penalty provision would not apply if:

(a) the debt was incurred as part of reasonable steps to maintain and return the company to "solvency" within a reasonable period of time; and

(b) the relevant director (or other advisor) held the honest and reasonable belief that incurring the debt was in the best interests of the company and its creditors as a whole; and

(c) the incurring of the debt would not materially increase the risk of serious loss to creditors.

Under this model, it would be unnecessary for the directors to actually seek the advice of a person who is an expert advisor in the restructuring of companies. The director would, nevertheless, have to obtain appropriate specialist advice in order to establish the factors that would provide the director with a "safe harbour" with respect to any challenges brought about as a result of the failure of the company to survive the rescue operations.

It is interesting to note that, if this package of proposed changes were adopted, it would be necessary for the directors to show that they were acting in the interests of the company, which would specifically include the interests of creditors. There is no legal duty owed by directors to creditors, but under the terms of the proposal it would be necessary for the directors to show that they acted with the interests of the creditors in mind.

The government also tabled the *Insolvency Law Reform Bill 2015* (Cth). The Honourable Kelly O'Dwyer, in introducing this legislation, noted that it was being released for further consideration because there was further work that needed to be undertaken by ASIC and other relevant bodies in ensuring that the legislative package to be finalised in 2017 was workable. The balance of the legislation is proposed to be presented to parliament in 2017.

This is an area where further government legislation is almost certain to be introduced as problems in the insolvency arena remain very significant.

Other potential reforms

As yet, there have been no discussion papers or any draft legislation to illustrate the way in which the government intends to respond in detail to the Murray Report. A broad overview of the government's reaction to the Murray Report was set out in its paper, "Improving Australia's Financial System – Government's Response to the Financial System Enquiry", which was released in 2015.

On 15 December 2016, when it appeared that there was likely to be no further clear government direction in this context, the government released two discussion papers to identify the current thinking in Canberra on two areas, the first being a discussion paper exploring the key policy issues to facilitate further developments of a framework for the retirement phase of the "superannuation system". The government announced that this discussion paper is "part of the government's response to the financial system enquiry (the Murray Report)". Through this process the government will invite feedback from consumer groups, the superannuation industry and other interested stakeholders on the proposed framework for facilitating trustees to offer what the Murray Report labelled "comprehensive income products for retirement" or "CIPRS". There are some broad general statements as to what this paper is intending to achieve, but in essence the government repeated what it said in 2015, that it will develop "more efficient retirement income products" which will aim to "facilitate trustees offering these products to members", in response to the Murray Report submissions to the discussion paper sought from stakeholders in particular on 3 topics:

- the *structure and minimum requirements* of these products;
- the *framework* for regulating these products; and
- the *offering* of these products.

Submissions close on 28 April 2017. It will be fascinating to see how effective the proposals will be. At the time of writing we have not had the opportunity to review the discussion paper.

On the same day, Assistant Minister O'Dwyer announced a second paper intended to review the superannuation system and its operation, along with two Exposure Draft Regulations. These are aimed at improving the superannuation reform package announced in the Budget. Submissions on these drafts are due in February. It has not been possible for us to review the relevant documents released by Minister O'Dwyer.

The government is determined to ensure that ASIC does take a more effective role in dealing with the problems that have arisen as a result of the collapse of many financial institutions, resulting in hundreds of millions of dollars of losses to consumers and investors. ASIC has already been provided with very significant increases in funding to deal with various areas of its operations. In particular, ASIC has been provided with funding as a result of the governments concerns with the apparent difficulty ASIC continues to face in regulating the financial sector.

As noted earlier, we have not had an opportunity to review these discussion papers, but it is highly likely that there will be quite a significant reaction to many of the recommendations that have been "floated" in broad statements made by Minister O'Dwyer and others in the context of the Murray Report recommendations.

A politically significant report that has now had the chance to be reviewed by the public is the House of Representatives Standing Committee on Economics report, "Review of the Four Major Banks: First Report (November 2016)" (the Banks Report). This report identifies a number of other significant initiatives that the government needs to take into account. In particular, there is a major recommendation to implement reforms in relation to the dispute resolution regime in order for it to operate.

The Banks Report provides further guidelines on the role of the proposed Credit and Investments Ombudsman and a Superannuation Complaints Tribunal which will, in the view of the Banks Report and regulators, provide a better regime to deal with issues surrounding the operations of banks and their relations to consumers.

A number of more technical recommendations have also been made in the Banks Report. These include recommendations on how banks can improve their obligations in this context, such as through the introduction of specific steps they need to take, particularly relating to the review of their own risk management frameworks, as well as the requirement to report to ASIC the actions they have taken in the relevant circumstances.

ASIC will also be asked to establish an annual public reporting regime for the wealth management industry, to provide the details of a number of matters associated with the operation of the financial sector. Finally, recommendation 10 of the report suggests that the government require each licence holder, operating under the relevant legislation, once the licence holder becomes aware that a financial advisor (either employed by, or acting as a representative for that licence holder) has breached their legal obligations, to contact each of the financial advisor's clients to advise them that such a breach has occurred.

Insofar as whistleblowing is concerned, the amendments made to the protection available to whistleblowers in the *Fair Work (Registered Organisations) Amendment Bill 2016* (Cth), introduced in the Senate on 22 November 2016, is but the first step in further changes that are likely to occur in the area of whistleblowing during 2017.

Finally, as is not uncommon at this time of the year, Treasury has also released an important discussion paper entitled, "Review of Tax and Corporate Whistleblower Protections in Australia", and has asked for commentary on the Government's approach in this area to various matters relating to it by 10 February 2017. This is an important initiative and one that in our view deserves a significant contribution from the community.

ASIC's actions and activities

The success of ASIC, in the last year, can not be easily assessed. As noted earlier, in discussing the Capability Review, there has been criticism of the failure of ASIC to bring forward difficult cases to test the way in which the legislation that it is required to administer has been complied with by the community. Suffice it to say, over the last two to three years there has been significant criticism of ASIC's performance, outside the comments made in the Capability Report. In particular the Senate Economics Committee's review, "Performance of the Australian Securities and Investments Commission", which covers ASIC's performance in 2013 (published 26 June 2014), was the subject of discussion in an earlier annual review of the performance of ASIC. See Annual Corporations Review 2014, page 11.

It is not our intention to discuss in any detail the various "ASIC enforcement outcomes" reports that ASIC has published during the course of the year (the main ones are reports 476 and 485, released 30 March 2016 and 8 August 2016 respectively). There have certainly been a significant number of disqualifications of directors and other fines imposed on directors pursuant to orders made by ASIC that have not been challenged by the relevant directors (and other officers). ASIC does not have the power to impose penalties (it must do so through court orders), but if the relevant director or officer does not challenge the ASIC orders made, including disqualification orders, then those particular orders take legal effect.

In 2016, ASIC has been aggressive in pursuing the disqualification of directors who the regulator believes have not complied with the requirements of the legislation. As readers will know, whilst ASIC can make decisions to pursue the disqualification of directors of companies where, in ASIC's view, breaches of the law have occurred, these decisions regarding the targeted directors are subject to review in the court. Over the last few months in particular, ASIC has issued a number of disqualification orders where the great majority have not been appealed in the courts, and as such the imposed disqualifications still remain valid. This system at least provides an opportunity for the regulator to move quickly, should it wish to discipline persons who it believes have not been complying with the law, or in more significant cases, to remove the relevant person's ability to act as a director of a company.

In this system, there is an important review safeguard available to the relevant individuals who are the subject of these ASIC orders, and in some cases the courts have overturned the ASIC disqualification as a result of this review process. However, there have been no recent decisions of late in which the actions taken by ASIC have been the subject of such a significant review to comment upon.

ASIC relies very heavily on the use of enforceable undertakings in seeking to undertake its regulatory roles in this regard. Many significant enforceable undertakings have been obtained by ASIC, most recently in a very high profile undertaking against Bayerische Motoren Werke AG (BMW). Rather than face court action for its apparent failure to comply with the legislation, which may have resulted in 15,000 customers suffering hardship, BMW cooperated with ASIC. In an announcement made on 6 December 2016, it was noted that an undertaking to repay $77 million to thousands of customers had been given by the company. This is a manifestation of the type of successes that ASIC has achieved through the use of enforceable undertakings. A number of comments have been made by Mr Greg Medcraft, the chairman of ASIC, as well as other Commissioners, that ASIC wishes to rely heavily on the use of enforceable undertakings in pursuing breaches of the relevant legislation. However, it continues to use both these and infringement notices in pursuing alleged breaches.

The ASIC Capability Report

It is important, before commenting on other aspects of ASIC's performance and initiatives, to discuss the report of the ASIC panel (under the chairmanship of Ms Karen Chester of the Productivity Commission) on the performance of ASIC. The report, which was released to the Federal Government in December 2015 but not made public until 2016, contains a number of very significant criticisms of the performance of ASIC in the context of the continued complaints that the legislation has failed many investors.

The ASIC Capability Report (the Capability Report) was released at the same time as the Productivity Commission's Business Set-up Report. The report is a damning one, in many respects, on the performance of ASIC, especially in the context of its litigation record. Whilst it described ASIC as having operated in line with "global best practice in some areas", in particular consumer education, there were a number of gaps in the context of ASIC's performance.

The Panel evaluated five key themes in the report, including:

1. whether ASIC had a "sound governance structure" – this was not well used in its view;
2. what it termed the "expectations gap" – this was greater than it had anticipated;
3. that there was plenty of opportunity for ASIC to reorient itself for greater external focus;
4. that there should be a cultural shift in ASIC so that it could become less reactive and even more strategic and confident; and
5. that future-proofing and forward-looking approaches were needed by ASIC.

The Panel noted that ASIC was reactive in its use of regulatory tools and was often responding to high profile issues rather than to issues that struck at the heart of consumers – especially financial scandals. The Panel considered ASIC's internal culture as defensive and inward-looking. It felt that ASIC was quick to react to criticism and tended to rely on its perceived lack of funding to explain its relatively poor progress in a number of areas.

The Panel also believed that ASIC was too reactive and risk averse, often displaying a limited desire to undertake litigation testing the bounds of the law. Interestingly, when the Panel discussed the current regulatory focus by ASIC in relation to the financial sector, it felt that "the efforts that regulators expect financial firms to make to improve and maintain their cultures do provide some salient lessons for ASIC with regards to its own culture" (see page 78). In recommendation 12, discussed at pages 19 and 79 of the Capability Report, the Panel recommended that ASIC should review its organisational structure.

In the Panel's view, ASIC tended to rely on enforcement as a "reactive tool". In its view, ASIC would be better off adopting a more balanced approach, taking on board very difficult cases rather than relying on marginal cases in administering its portfolio of regulatory responsibilities. In that context, although not mentioned in the report of the Panel, the aggressive attitude taken by ASIC in relation to Fortescue Metals (see *Forrest v Australian Securities and Investment Commission; Fortescue Metals Group Ltd v Australian Securities and Investment Commission* (2012) 247 CLR 486; [2012] HCA 39) reflected a much more willing approach by ASIC to test the parameters of the law.

As noted elsewhere, it is our view that ASIC uses the infringement notice far too readily to deal with areas where difficulties are encountered in administering its portfolio. Enforceable undertakings are heavily used by ASIC, although it has suggested that it may cut back on its use of such undertakings in the future.

As a result of the Capability Report, the government voted ASIC a considerable sum of extra money, and in particular, well over $100 million to provide further assistance and guidance to the community in the banking and financial services sector. The impact of the increase in funding and the work that ASIC is pursuing in this area has already been seen in a number of high profile cases being run by ASIC against major trading banks, with more litigation promised in the future.

The relevance of poor "culture" in ASIC's ongoing regulatory role

As noted earlier in this review, ASIC has been prominent in targeting the failure of directors of major companies, especially in the financial and banking sectors, to embrace appropriate culture in ensuring that their companies complied with the operations of the legislation. Calls by Greg Medcraft to introduce criminal sanctions to deal with alleged breaches of culture were later withdrawn, but resulted in significant criticism of this attempt to criminalise the discovery of poor culture, and the punishment of directors for engaging in conduct that embraces such poor culture. In particular, Colvin and Argent in their article in the *Company & Securities Law Journal*, "Corporate and Personal Liability for 'Culture' in Corporations?", criticise this attempt to criminalise culture. It is not appropriate, in our view, for culture to be identified in this form.

The difficulty that we face (and similar comments have been made by lawyers and judges) with ASIC is its continuance to highlight the absence of appropriate culture without obtaining orders from a court in evaluating the alleged breaches of the law that may have occurred in the context of such poor culture. This is puzzling in the light of the significance that has been provided in our law in dealing with the question of culture and in particular the need for companies to ensure that the companies embrace culture of compliance. The retiring chief justice of the High Court of Australia, French J, whilst sitting as a member of the Federal Court of Australia, discussed this particular issue in *Re Chemeq Ltd* (referred to earlier). The decision, whilst a very significant one in the context of the culture of compliance, is in fact not a binding decision, in the strict sense, because the litigation was settled because ASIC had sued the relevant company for its failure to comply with the disclosure requirements imposed upon the company in issuing a relevant prospectus for a new product. An agreement was reached between ASIC and the company to settle the relevant litigation with the company in effect agreeing to a penalty being imposed.

In approving the relevant settlement, French J took the opportunity in his obiter dicta comments to highlight the importance of companies, such as the defendant company in this case, but more generally, to adopt a greater awareness and attention to the significance of the Code. That Code introduced into federal criminal law an important obligation on all companies governed by federal law to put in place appropriate risk compliance and relevant arrangements to ensure that the companies the relevant directors were responsible for adopted and maintained an appropriate culture of compliance. In lengthy obiter dicta statements, French J highlighted the nature of the Code by reference to the responsibility of the boards of corporations and similar organisations to ensure that appropriate risk management programmes are in place and are continually reviewed and updated. The concept of a culture of compliance becoming critical and central to the way in which companies operated has not been something that we have observed has been adopted with enthusiasm or general willingness on the part of many Australian corporations.

It is important to note, however, that regrettably, many organisations appear not to be taking the importance of the culture of compliance seriously enough. Indeed, as Justice Heerey noted in *Australian Competition and Consumer Commission v Visy Industries (No 3)* [2007] FCA 1617, the relevant company in that case completely ignored its obligations and its compliance program may as well have been written in Sanskrit for all the good that it may have achieved.

In our view, the judgment of French J does not seem to have been regarded as critical in commenting on the so called absence of an appropriate culture on the part of directors. It seems to us that this is the starting point: dealing with the alleged failure of directors of companies to adopt an appropriate culture in carrying out their activities. In the absence of court orders being obtained for the failure of company directors (or officers or indeed others) to comply with the requirements of the legislation, and if the court is not given an opportunity to evaluate the alleged breaches of the law that have occurred, continued complaints about the so-called absence of culture, are, with respect, almost as good as "whistling in the wind", in the sense that they will not impact in any significant way on how directors and others will behave.

The major litigation in which ASIC will be involved during 2017 is against the three major trading banks in relation to alleged market rigging. The judge hearing all three cases – Beach J – has indicated that it will take some months for the hearing to be conducted and it will be some further months following the hearing until we are likely to see a judgment.

In the meantime, ASIC will face some significant challenges once the recommendations for law reform, and new statutory provisions, are introduced on the basis of the Murray Report, referred to earlier.

The ASIC Annual Report 2015–2016

It is useful to comment on this report, which was released on 31 October 2016.

The chairman of ASIC unsurprisingly continued to emphasise "culture" as being a key enforcement priority of ASIC during this period. Mr Medcraft states in the Chairman's Report that culture is a "key driver of gatekeeper conduct", with ASIC committed to having culture as a central focus of their activities well into the 2016-17 period.

Over the reporting period, ASIC conducted 1,441 high intensity surveillances, 175 investigations across regulated sectors, and the review of over 9,000 reports of misconduct from the public. In addition, it disqualified 39 individuals as company directors as a result of its investigations.

The Report noted that ASIC withdrew $44 million from its "enforcement special account" in order to fund litigation against the major banks over the allegations of rate-rigging the bank bill swap rate (as mentioned above). This "enforcement special account" is a departmental account designed to fund the costs of ASIC arising from the investigation and litigation of matters of ″significant public interest″.

ASIC continues to rely on infringement notices as part of its activities. It issued 109 notices during this period. Penalties totalling $2.3 million have been paid to the Commonwealth as a result of these notices. It is our view that the use of infringement notices should be reduced significantly as they do not result in any major rulings on what the law stands for and how it is to be interpreted.

In April 2016, ASIC made a submission to the Federal Government calling for a review of the current penalties that may be imposed under the Act. This review is ongoing and the government has announced they will not be attending to these recommendations until 2017.

ASIC has also continued to assist the government on policy issues. An important example of this is in the development of the *Insolvency Law Reform Act 2016* (Cth), which includes provisions to provide a "safe harbour" to company directors to avoid personal liability when they attempt to save their company from collapse.

ASIC has also been very interested and made a number of comments in relation to whistleblowing, which has become a high profile initiative on the part of the government, as is noted elsewhere.

Finally, ASIC has thanked the government for the increased funding. As far as its future challenges are concerned, ASIC has noted that these are:

1. aligning conduct in a market-based system with investor and consumer trust and confidence;
2. digital disruption and cyber resilience in our financial services and markets;
3. structural change in our financial system through increasing market-based financing, led by the growth in superannuation;
4. complexity in financial markets and products, driven by innovation; and
5. globalisation of financial markets, products and services.

A number of reports have been issued by ASIC during the course of the year. Its market integrity report, released in November 2016, concerns its increased involvement in overseeing the operation of our securities trading markets. It is unnecessary to delve into the issues that ASIC has highlighted in relation to these activities. The report also provides an overview of ASIC's increased attention to the operation of this sector of the market. ASIC's involvement in this area will grow as a result of the recommendations of the Murray Report that will be introduced into the legislation in 2017.

Leading cases

To whom the directors owe their duties

As readers of this overview will recall, the High Court of Australia had granted leave to hear an appeal in the *Bell Group* litigation (*Westpac Banking Corporation v Bell Group Ltd (in liq) (No 3)* (2012) 44 WAR 1), following the arrangements reached between the directors of the company and the liquidator of the relevant company when it collapsed. The Western Australian Court of Appeal (a specially constituted court of appeal) decided by majority that the directors had breached their duty to act in good faith and in the best interests of the company by not considering the interests of all creditors, but merely concentrating on the interests of the banks. Acting Justice of Appeal Carr disagreed with the majority judgment – a view that we support. The High Court had been expected to hear the appeal, but the case was settled.

The question of whether directors do owe duties to a broader range of interests than simply those of the shareholders, as espoused by the High Court in *Spies v R* [2000] HCA 43, remains a "hot topic" and one that is very interesting. It is our view that the current legal position in Australia remains the same – that the duty is owed by the directors to the shareholders (members); however, as Justice Mason so carefully enunciated in *Walker v Wimborne* (1976) 137 CLR 1, directors who did not take into account the interests of creditors, especially in a company that was in financial difficulties or facing similar problems, would be foolish. Should we change the law to require directors to take into account broader stakeholder interests? Is this a legislative initiative or should we continue to rely on the courts evaluating these questions in each case, as for example, Justice Edelman did in *Australian Securities and Investments Commission v Cassimatis (No 8)* [2016] FCA 1023? In these cases the judges have avoided having to decide the question of whether any legal duty arose – they simply discussed the matter in broader terms.

The Governance Institute of Australia has continued to pursue a strong policy of supporting and broadening our law to require directors to take broader interests into account. If the Productivity Commission's Business Set-up Report is embraced in the law – as suggested by Treasury in its discussion paper – there will be a duty imposed on the directors who, in trying to rescue companies, will need to take into account the position of creditors in that scenario. We will not, in our view, introduce legislation along the lines of s 172 of the *Companies Act 2006* (UK), which gives clear indications to directors that they should take into account other relevant interests.

The subject matter of this topic is one that has been discussed in two important papers. The CAMAC report "The Social Responsibility of Corporations" (2006) assessed the issues, and the Parliamentary Joint Committee on Corporations and Financial Services in the report "Corporate Responsibility: Managing Risk and Creating Value" (2006) also reviewed the arguments. The question of whether the duty of directors should be broadened in the context of just to whom are they to be owed, was the subject of a paper Bob Baxt delivered at the Federal Court of Australia/Law Council of Australia Business Law Section conference on Corporations Law on 26 August 2016, entitled "Corporate Social Responsibility (CSR) and 'Contemporary Community Expectations'". An article by Professor Jean Du Plessis, to be published in the *Companies & Securities Law Journal* in 2017, examines the issues from the perspective of the corporate governance movement.

It is clearly an important topic and one that will be the subject of ongoing debate. However, in considering the duties of directors in the context of the current law, and the cases that have been decided in the calendar year 2016, these particular issues are not treated with the degree of importance that perhaps many in the community would like them to be. They do, however, influence the call for an increase in the concentration on corporate "culture" and related issues raised by ASIC which are discussed in this overview.

The duties of directors – duties of care and diligence

There is little doubt that the most discussed decisions provided by our courts, from the High Court down to District and County Courts, have involved directors' duties. In this context, we will discuss in the first place the duties of care and diligence as enunciated in a number of cases from courts throughout Australia. This duty will be the most prominent of the duties discussed. But the other duties, both fiduciary and non-fiduciary, both under the provisions of the Act or general law or pursuant to other legislative regimes, will also be evaluated. It is not possible to discuss all of the cases that have been decided. Our choice of leading cases may not be the choice of others, but we hope that they provide a very broad and useful overview of the obligations that faced directors (and other officers) in this context.

Associated with the duty of care and diligence, which is of course both a statutory duty and a duty at common/general law, there have been a number of cases which have highlighted the significance of duties requiring directors not to allow a conflict to occur between their obligations to the company and their individual interests in corporations.

Remedies that may be available both to the regulator ASIC, or to shareholders and others, have also been at the centre of these cases. Increasingly, the decisions have arisen out of the operation of managed investment schemes and the role of different organisations within the managed investment scheme structure, as well as the differentiation between the obligations of the directors of the company that is at the heart of a managed investment scheme, as well as those of the responsible entity and others associated with the company's administration.

The ongoing debate as to whether directors of companies must take into account their other interests, whether by way of a compulsory obligation arising out of specific provisions and law, or by virtue of community expectations, has increased the intensity to a debate on whether the law should be amended to make it not only feasible but necessary for directors to take these other interests into account.

Cassimatis

In August 2016, Edelman J, whilst sitting as a Federal Court Judge (preceding his recent appointment to the High Court of Australia), delivered a significant judgment on the duties of care and diligence (and related matters) in *Cassimatis* (*Cassimatis*). In that case, he was faced with the quite unusual situation of evaluating the duties owed by the only two directors of a company, Storm Financial Corporation Ltd (Storm), following the failure of a number of investment arrangements that, through the drive and initiatives of the two directors – Mr and Mrs Cassimatis – had been sold to various sectors of the community.

This was a case involving not only "mum" and "dad" investors, seeking spectacular returns, but also centred around the heavy commitment by a number of professional and skilled investors in the market being enticed to "chance their arm" in the unusual investment arrangements that the Storm organisation were offering. *Cassimatis* will be worthy of much more detailed evaluation, not only because of the duties of care and diligence that Edelman J focused on in his lengthy judgment, but also ancillary questions that are raised in that case. These include the power of the court to forgive directors under ss 1317S and 1318 of the Act, the so-called "stepping stone theory" associated with potential claims of breaches of the law having occurred – a matter that had been raised previously by ASIC. As will be noted later, it has been the subject of attention in a number of cases, such as *Australian Securities and Investments Commission v Fortescue Metals Group Ltd* [2011] FCAFC 19 (*Fortescue*), discussed previously by Brereton J in the case of *Australian Securities and Investments Commission v Maxwell* [2006] NSWSC 1052 (*Maxwell*) and further by Beach J in *Australian Securities and Investment Commission v Mariner Corporation Ltd* [2015] FCA 589 (*Mariner*).

In addition to these cases dealing with traditional areas of corporate law, there have also been a number of significant decisions in the area of management and investment schemes. We will discuss briefly in the context of duty of care and diligence the decisions of Wigney J in *Trilogy Funds Management Ltd v Sullivan (No 2)* [2015] FCA 1452 (*Trilogy*), and the decision of Murphy J in the affairs surrounding the alleged breaches of the law by Dr Lewski in the cases of *Australian Securities and Investments Commission v Australian Property Custodian Holdings Ltd (Receivers and Managers appointed) (in liq) (Controllers appointed) (No 3)* [2013] FCA 1342 (the breach decision) and *Australian Securities and Investment Commission v Australian Property Custodian Holdings Ltd (Receivers and Managers appointed) (in liq) (Controllers appointed)* [2014] FCA 1308 (the penalty decision) (together known as the *Lewski* cases) (*Lewski*).

In the *Cassimatis* decision, Edelman J, after reviewing some earlier decisions in Western Australia and other jurisdictions on the interpretation of s 180(1) of the Act, turned to more recent cases in which the statutory duty of care was being considered carefully by our courts. He referred briefly to part of the judgment of the High Court of Australia in the case of *Australian Securities and Investment Commission v Hellicar* (2012) 88 ACSR 246; [2012] HCA 17 and the decision in *Shafron v Australian Securities and Investment Commission* [2012] HCA 18, highlighting the standards that are expected of directors. In particular he referred to the decision of Ipp J, in the Western Australian Supreme Court, in *Vrisakis v Australian Securities Commission* (1993) 9 WAR 395, among other cases, to reflect on the high standards that were expected of directors 20 years ago.

After carefully considering the evidence in this case, in the context of two investors in the Storm Company at the centre of the case pleaded by ASIC, Edelman J noted that whilst great efforts had been taken by the directors to ensure that appropriate guidance had been given to them on the investments to be entered into – investments that might have been regarded as "aggressive" – that certain other factors needed to be taken into account. He added that directors in a company such as Storm with the responsibilities imposed upon such directors in the circumstances surrounding the company:

> would have realised that the application of the [Storm] model to people in the pleaded circumstances was likely to involve inappropriate advice. The reasonable director would have taken some alleviating precautions to prevent the giving of that advice. I reach this conclusion for the detailed reasons given later, but with a strong awareness that it is made in the context that a director's powers to act are, of the very nature of corporations, ones which often require risks to be taken. (*Cassimatis* at [22]).

In considering the duty of care pursuant to s 180(1) of the Act, Edelman J confirmed that the duty of care and diligence was a duty that:

> is not merely owed to the company … in the way that the literal terms of the duty are tied to the exercise by directors of their powers *expressed generally* and to the discharge of their duties *expressed generally* … s 180(1) does not, in terms, confine the duties and powers of directors to those duties and powers which are imposed upon them, and conferred upon them, *by the company*. Some duties of directors are duties which are undertaken by the director to the company. But other duties of directors, in their capacity as directors, are imposed by law (*Cassimatis* at [470]).

His Honour confirmed that in assessing the extent to which the duties of care and diligence should be applied to company directors it was not necessary to refer to any other reference point than that the duties were owed to the company. He was prepared to proceed on the basis that the duties owed by the directors were:

> public duties as directors in managing Storm [and] could only be contravened if they acted contrary to *Storm's* interests rather than contrary to any general norm of conduct (*Cassimatis* at [478]).

Edelman J recognised the degree of care and diligence required by the relevant section of the Act is fixed as an objective standard:

> identified by reference to two relevant elements – the element identified in [s 180(1)] para (a): "the corporation's circumstances", and the element identified in para (b): the office *and* the responsibilities within the corporation that the officer in question occupied and had (see *Cassimatis* at para [493]).

Edelman J added, in commenting on the duties owed by directors, that much of what he had to say will also be relevant in assessing the duties of other officers of the relevant company.

Edelman J also found helpful comments made by Beach J in *Mariner* (noted above). In that case, Beach J noted that in evaluating whether directors had breached their duties in a particular case, the court, in considering the various matters under dispute, would look at:

> factors including the director's position and responsibilities, the director's experience and skills, the terms and conditions on which he has undertaken to act as a director, how the responsibility for the company's business has been distributed between the directors and the company's employees, the informational flows and systems in place and the reporting systems and requirements within the company (*Mariner* at [441]).

In his conclusions, Edelman J noted that in exercising any adventurous investment strategy of the kind involved in a case such as this, the directors would have to link the duties they owed to the company to the general duties that would apply to all companies whether failing or not. He rejected the arguments put by the directors that they should be excused because they had obtained approval of their conduct from the company – they were the only shareholders. There is a significant amount of authority, both recent and from the past, which rejected the argument that directors can obtain ratification of breaches of these duties – especially statutory duties – by the vote of the shareholders. This would be particularly relevant where the directors are the only shareholders of the company.

The fact that the directors owed their duties to the company, and in noting that ASIC is the body that needs to obtain public sanctions in relation to how these duties are to be evaluated, did not, in the view of the judge, minimise the proposition that the relevant duty of care is owed to the company in the context of its broader role in the community. Edelman J's statements cannot be taken to suggest that the duty of care under the statute is one that is owed to a broader body of stakeholders notwithstanding the fact that directors must continue to act and behave in a way where their corporate law obligations are complied with, but all legal obligations are in fact complied with by them on behalf of the company.

It is highly likely that this decision will find its way through the Full Federal Court to the High Court of Australia. Whilst Edelman J will not be sitting on any High Court decision in this case since his elevation to that particular body, it is quite likely that his views will have a significant influence on the way in which members of the High Court, if given the opportunity, will evaluate many of the issues raised by this important decision in the context of the duty of care in diligence.

Management investment companies

As noted earlier, the duty of care and diligence has been the subject of great interest in the area of managed investment schemes. In that context, it is useful to discuss two leading judgments in that area, as well as some ancillary cases, before turning to other aspects of the duties of directors.

In a series of interesting cases dealing with the alleged breaches of duties of directors of management investment companies, ASIC has sought penalties and remedies against directors of a number of companies where there has been a failure in the affairs of different parties in a management investment company structure. There is a complex structure required to be adopted by virtue of quite complex legislation. The "responsible entity", which has a trustee-like position, must ensure that its conduct is not influenced by the needs of the investors in ways which suggest the breach of fiduciary duties of a general nature as well as specific rules set out in the legislation. Some of the recent cases show how careful the relevant officers in the different company structures need to be.

Apart from ASIC litigation, there has also been some private litigation which has raised a number of interesting questions. In this overview, we can only comment on certain aspects of the decisions which raised questions concerning the actions of directors. Apart from cases being brought by ASIC in this context, there have also been instances of private litigation. However, in this overview we do not intend to deal with many of these cases but to comment on a few decisions.

In the two major decisions – referred to as the *Lewski* cases above – Murphy J ruled that the directors of the relevant companies involved in the managed investment scheme (the details of the scheme are not necessary for us to discuss) had breached various duties. As a result, he imposed significant penalties, including disqualification and monetary penalties. ASIC had based its legal proceedings on the fact that the alleged breaches of duties had occurred on 22 July 2006.

The Full Federal Court, in reviewing this decision (*Lewski v Australian Securities and Investments Commission* [2016] FCAFC 96), ruled that there had been a mistake by ASIC in its analysis of the relevant decision-making process and that indeed, the decision taken by the board of directors was outside the statute of limitations relied upon by ASIC in finding that there had been a breach of duty. Accordingly, the penalties imposed by the court were dismissed.

In the course of his judgment, Murphy J made strong statements concerning the obligations that directors take with appropriate care and diligence and highlighted the fact that the duties had in fact been "heightened" so that a much stronger statement of principle was necessary for the court to comment upon.

There are still some ancillary questions to be decided on matters arising from these cases but they do not impact on the important statements on the duties of care enunciated by Murphy J.

In the *Trilogy* case, referred to above, Wigney J confirmed the approach taken by Murphy J in evaluating the duties of the relevant responsible entity and others associated with the management investment funds. In discussing the duties of directors in this case, Wigney J not only relied on the application of s 180(1) of the Act, but also on s 601FD of the Act. This provision deals specifically with the duties of officers of responsible entities in managed investment scheme scenarios. Wigney J cited a significant number of cases in his judgment, and made these important comments at [201]:

> whilst the test for the standard of care in s 180(1) of the Corporations Act is objective, it has some subjective elements. In determining whether a director or officer has exercised reasonable care and diligence, regard will generally be had to the company's circumstances and the director's position and responsibilities within the company. The relevant circumstances include: the type of company involved; the provisions of the company's constitution; the size and nature of the company's business; the composition of the board of directors; the particular director's position and responsibilities within the company; the particular function the director was performing; the experience and skills of the particular director; the terms upon which he or she has undertaken to act as a director; the competence of the company's management; the competence of the company's advisors; the manner in which responsibility is distributed between the company's directors, officers and employees; and the circumstances of the particular case.

He cited with approval decisions of Santow J in *Australian Securities and Investments Commission v Adler* (2002) 168 FLR 253; [2002] NSWSC 171 and also the decision of Middleton J in *Australian Securities and Investments Commission v Healey* (2011) 196 FCR 291; [2011] FCA 717.

In addition to the long list of matters that are relevant in evaluating the duties of care and diligence that the court will take into account, he also noted (at [166]) that:

> directors are required to take reasonable steps to place themselves in a position to guide and monitor the management of the company. A director must become familiar with the fundaments of the business in which the corporation is engaged; a director is under a continuing obligation to keep informed about the activities of the corporation; directorial management requires a general monitoring of corporate affairs and policies, and a director should maintain familiarity with the financial position of the corporation.

He emphasised, as had Justice Murphy in *Lewski*, that it was vital potential conflicts of interests between the responsible entity and the interests of the members of the scheme were paid close attention by the directors, and that the failure of directors to take these matters into account would always prove fatal.

To our knowledge the *Trilogy* decision has not been appealed.

There have been a number of fascinating articles written about this area. In particular, readers are referred to the recent article published in 2016 by Dr Rosemary Langford in the *Company & Securities Law Journal* titled “The Corporate Culture Chameleon – Reflections and Reporting”.

The relevance of the “stepping stone” theory in assessing a director’s duty of care and diligence

An interesting aspect of the decision of Edelman J in *Cassimatis* is his discussion of what can be described as the “stepping stone theory” in ascertaining potential liability of directors’ duties for beaches of the law. As noted earlier, this theory was enunciated by a number of judges. Brereton J, in the case of *Maxwell*, commented on it in a negative fashion. However, Keane CJ, who was the Chief Justice of the Federal Court at the time in *Fortescue*, suggested that it was a viable policy that ASIC could pursue. Most recently, Beach J in *Australian Securities and Investment Commission v Mariner Corporation Ltd* preferred the view of Maxwell J. It is likely to be a matter of some interest moving forward and is the subject of an interesting commentary in the 2012 *Federal Law Review* article “Stepping Stones – From Corporate Fault to Directors’ Personal Civil Liability”.

In *Fortescue*, the Federal Court, in reversing the initial decision that there had been no breach of the continuous disclosure provisions and no misleading or deceptive conduct on the part of the company and its chief executive Andrew Forrest, agreed with the reasoning of Keane CJ that not only had there been a breach of the continuous disclosure and misleading or deceptive conduct provisions of the Act, but that Andrew Forrest had also been in breach of his duties of care and diligence. His failure to ensure that the company complied with the continuous disclosure regime and avoided making misleading or deceptive statements to the then Australian Stock Exchange (as it was then known) amounted to a breach of duty of care. In his view, that breach was a serious one and it led to further breaches. Keane CJ agreed with the submissions of ASIC that, by virtue of this combination of events, ASIC was entitled to bring further proceedings against Forrest for breaches of duty of care and diligence (pursuant to s 180(1) of the Act). By ruling in this fashion, Keane CJ and the Federal Court opened the way for ASIC to seek disqualification and other penalty decisions against Forrest.

As it turned out, the ruling by the Federal Court that there had been a failure to comply with the continuous disclosure provisions, and that there had also been a breach of misleading or deceptive conduct provisions of the Act, had not been substantiated, and so liability was not imposed on the company or on Forrest. The High Court, in doing so, did not in any way contradict the rulings of the Full Federal Court, and in particular the judgment of Keane CJ, that the combined factors enabled ASIC to seek a harsher penalty than might otherwise have been available to it.

It is useful to set out short extracts from the decisions of Beach J in *Mariner*. In that commentary, he relies heavily on the remarks of Brereton J in *Maxwell*. In dismissing the claim by ASIC that it could use such a theory to broaden a range of penalties being sought against directors. Beach J noted:

> There are cases in which it will be a contravention of their duties, owed to the company, for directors to authorise or permit the company to commit contravention of provisions of the [Act]. Relevant jeopardy to the interests of the company may be found in the actual or potential exposure of the company to civil penalties or other liability under the Act, and it may no doubt be a breach of a relevant duty for a director to embark on or authorise a course which attracts the risk of that exposure, at least if the risk is clear and the countervailing potential benefits insignificant. But it is a mistake to think that ss 180, 181 and 182 [of the Act] are concerned with any general obligation owed by directors at large to conduct the affairs of the company in accordance with the law generally or the Corporations Act in particular; they are not. They are concerned with duties owed to the company (see *Mariner* [444] where Justice Beach quoted from the judgment of Brereton in *Maxwell* [104]).

As noted earlier, Edelman J in *Cassimatis* also commented on this theory. He suggested that the theory was one that did not have strong support in the law:

> To borrow the expression of Keane CJ in [*Fortescue*], ASIC relied upon an actual breach by Storm as a "stepping stone" for a finding that Mr and Mrs Cassimatis contravened the Corporations Act. I have serious doubt whether an actual breach by a corporation is a necessary requirement for breach of s 180(1) by an officer … it might be seriously doubted whether the director could escape liability simply because, by some good fortune, no actual breach eventuates. Loss is not a required element of an action for contravention of s 180(1) of the Corporations Act (*Cassimatis* at [4] and [5]).

A more recent academic discussion of the theory is contained in an article by Dr Rosemary Langford, entitled "Management Investment Schemes: Liability of Directors of Responsibilities Where the Responsible Entity Breaches the Law" (2016) 34 CSJ 599.

Ancillary cases reflecting on the duties of directors in management investment company organisations

Before turning to briefly discuss other duties by directors in the context of their fiduciary obligations to avoid conflict and interest, it is useful to briefly discuss further decisions in the management and investment regime. The first of these cases we note is a very significant one, that being the decision of the New South Wales Court of Appeal in *AMP Life Ltd v AMP Capital Funds Management Ltd* [2016] NSWCA 176 (*AMP Life*).

In essence, the case concerned the wish of the major company in the AMP Group of Companies, namely AMP Ltd, to impact on the voting to be undertaken in the responsible entity involved in the managed investment scheme, AMP Capital China Growth Fund (AMP Fund), which in turn involved the actions to be taken by AMP Life Ltd (AMP Life), which was an associate of the relevant responsible entity (AMP Capital). The case raised very interesting questions of conflicts. The New South Wales Supreme Court, through Justice Brereton (in *Re AMP Capital Funds Management Ltd* [2016] NSWSC 986) ruled that AMP Life could not vote in the affairs in the relevant AMP company, AMP Life, because of s 253E of the Act. This prohibits a member from voting where there is a link between the member and the responsible entity.

The case was appealed in the New South Wales Court of Appeal, where Barrett AJA (sitting as an associate Judge) delivered the judgment on behalf of the court. He noted in the judgment of the Court of Appeal that there was:

> a clear statutory preoccupation with the role of a responsible entity as a guardian and protector of the interests and welfare of members [of managed investment schemes] and, as necessary, with subordination of any conflicting interest of the responsible entity itself (at [24]).

He examined the rationale behind s 253E and added these useful comments:

> The reason for extending the prohibition to associates is that it is recognised that associates may act together to procure a result that benefits any one or more of them, notwithstanding that it might not directly benefit the individual associate. The disqualification of a responsible entity would achieve nothing, if its associates were all at liberty to vote in the manner in which the responsible entity would desire. It is the fact of their association, not their interest, which is critical. If any one of a number of associated entities has an extraneous interest, there is potential for the others to vote by reference to the association rather than by reference to their own independent interests (at [13]).

This preoccupation with conflicts and potential impact of conflicts is absolutely critical to the way in which ASIC is currently reviewing the behaviour of company directors and others involved in corporations. To our knowledge, no appeals have been brought in this litigation to date and it is unlikely that we will see any appeal in this context.

In addition to this interesting decision it is useful to note two other cases. In *Australian Securities and Investments Commission v Managed Investments Ltd (No 9)* (2016) 308 FLR 216; [2016] QSC 109, Douglas J ruled that the various directors of the MFS Investment Management Corporation had misappropriated funds that belonged to the company, in breach of their duties. In his view, the directors were guilty of fraudulent conduct, allowing criminal sanctions to be imposed. In addition to considering ss 180–184 of the Act, then evaluating the conduct, Douglas J also relied on specific provisions of the Act dealing with managed investment schemes – namely s 601FC and other relevant provisions.

Finally, the decision in *Re Macquarie Investment Management Ltd* [2016] NSWSC 1184 provides another interesting illustration of where the court had found the directors breached certain duties out of the company by allowing a conflict to arise in the management of the relevant investment scheme organisations.

Other interesting cases in the area of company directors and their duties

There are a range of other interesting cases in which the duties of company directors have been considered by the courts. In these cases, the courts continued to affirm the strongly held view that directors must not allow a conflict of interest in duty to occur, and must not act in their own interests at the expense of the company, taking advantage of company's assets and opportunities in pursuit of their own interests. Some of these cases also raise questions alleging oppression or other remedies being sought by shareholders/directors in the capacity of shareholders of the company, or as a result of an investigation by ASIC.

In *Cooper v LCM Litigation Fund Pty Ltd* [2016] NSWCA 37, the New South Wales Court of Appeal affirmed the decision of the trial judge that attempts made by Cooper, who was the former joint managing director of LCM Management Fund Pty Ltd (LCM), to divert funds for his own personal use, amounted to a breach of duty. In addition, it was alleged that Cooper had pursued certain business opportunities, which it was argued belonged to the company, as though these belonged to him. This, it was argued, amounted to a conflict of duty and interest.

Payne JA, on behalf of the Court of Appeal, relied on a number of interesting cases, including *Pilmer v Duke Group (in liq)* (2001) 207 CLR 165; [2001] HCA 31; *Hospital Products Ltd v United States Surgical Corporation* (1984) 156 CLR 41; and *Chan v Zacharia* (1984) 154 CLR 178, to confirm the obligation of the relevant director to seek approval from the company if the director could undertake the opportunity which arose from his directorship of the company.

He agreed with the decision of the trial judge, Beach J, in *Prestige Lifting Services Pty Ltd v Williams* [2015] FCA 1063. In that case the judge reached a similar conclusion. It was clear to him that two of the directors were using their position to gain an advantage for themselves and thus caused detriment to the company. In addition to finding a potential breach of ss 183 and 181 of the Act, he also ruled there had been breaches pursuant to the second limb of *Barnes v Addy* (1864) LR 9 Ch 244.

In *Australian Securities and Investments Commission v Management Investments Ltd (No 9)* (2016) 308 FLR 216, Douglas J ruled that the various directors of the MFS Investment Management Corporation had misappropriated funds belonging to the company. In his view, the directors were guilty of fraudulent conduct (which allowed criminal sanctions to be imposed if necessary). In addition to the provisions in ss 180–184 of the Act, Douglas J also relied heavily on the specific provisions relating to the investment schemes – namely s 601FA – and other principles. In that context, *Re Macquarie Investment Management Ltd* [2016] NSWSC 1184 is another interesting decision in which liability was held where directors were held to have breached their duties owed to the company and allowed a conflict to arise in the management of the relevant managed investment scheme of companies.

There have of course been many other cases in which the duties of directors have been considered. Perhaps the most significant decision, in which ASIC was partially successful but suffered a rather stunning set-back, is the recent Victorian Supreme Court decision in *Australian Securities and Investments Commission v Flugge and Geary* [2016] VSC 779. This case followed the collapse of the Australian Wheat Board Ltd (AWB) and prosecutions against a number of directors of the

Wheat Board following a Royal Commission Report which suggested that there had been breaches of the law committed by various directors in the company supporting the United Nations Oil-For-Food Programmes

After a number of years, with a series of cases being brought, and very minor successes being achieved by ASIC, it suffered a significant loss in the Supreme Court decision. Whilst the Supreme Court held that Trevor Flugge, the chairman of the directors, was in breach of his duty of care and diligence, and made certain orders against Flugge (for which ASIC is now seeking penalties), it failed in its action against Geary and Flugge for more serious allegations of breach. The cost of this litigation and investigation has been enormous and will, in our view, be a matter of some significance in ASIC's consideration of bringing criminal charges in the future.

Concluding comments on directors' duties

In this section we have only dealt very briefly with a range of interesting cases which have been the highlights of 2016. It is anticipated that a significant increase in the litigation in this area will occur during 2017 as a result of ASIC's determination to become more "interventionist", to challenge wrongdoings where "bad culture" may be linked to breaches of the law, and more generally to show that it is to become a more effective regulator. The use of litigation funding, as will be discussed further below, will also become an important factor.

The continued reach of provisions punishing fraudulent and related activity by directors

While s 588G of the Act – namely, the insolvent trading provisions – is quite often used by ASIC in seeking remedies against directors who allowed companies to fall into financial difficulty, a range of statutory provisions, namely ss 588FDA and 588FF of the Act, being used together, provide a company liquidator (or other similar administrator) with an avenue to recover payments from directors where the directors have engaged in activities on behalf of companies, which are insolvent, and where transactions have favoured the directors in one form or another. The decision in *Crowe-Maxwell v Frost* [2016] NSWCA 46, however, is an illustration of a case where the court will not necessarily always rule in favour of the liquidator in situations where such actions are brought.

The relevant company in this case ran a childcare business at the premises owned by the relevant directors of the company I & K Frost Pty Ltd (namely Mr and Mrs Frost). Mr Frost ran the business himself and his wife assisted him. Books were not kept in the more traditional fashion and in due course the relevant business became involved in activities which led to financial difficulties. The company was wound up by the workers compensation nominal insurer and the liquidator, Crowe-Maxwell, sought to recover payments that had allegedly been made by the company to the relevant directors' benefit funds. It was argued that these payments breached provisions such as s 588FDA in that they were voidable transactions. The liquidator also sued the directors on the basis that they breached their duties owed in law to the company. The liquidator lost at first instance and an appeal was brought to the New South Wales Court of Appeal.

The Court of Appeal (comprising Beazley P and MacFarlan and Gleeson JJ) confirmed the decision of the trial judge on the basis that the action taken by the relevant directors was not unreasonable in the context of the work that they were putting into the company. There was insufficient evidence to show that the business of the company was being run inappropriately by the relevant directors. President Beazely, on behalf of the Court of Appeal, rejected the claim by the liquidator that the mere fact that certain payments had been made with reference to personal expenditure, and that there were no company records to explain these expenditures, was not completely conclusive. Indeed, the evidence illustrated that there had been a great deal expended by the directors in running the company. The directors continued to use the premises of the company and also other assets of the company, but the court did not regard that this use amounted to an inappropriate utilisation by directors, who basically ran the company on their own in carrying out the company's business.

The decision clearly shows the willingness for courts to review such claims in appropriate cases. It is unusual for the courts to find in favour of directors rather than the administrators or liquidators but, if the evidence is strong in favour of the directors, courts will make an appropriate decision.

The ability of directors to access board papers

In the previous pages of this review, we have examined the duties of directors, and in particular a range of duties under both statutory and common law. Directors also have significant rights. Sometimes these rights overlap with the rights of the directors as shareholders or members of a relevant company.

One of the most interesting rights that has now been cemented in legislation, namely s 247 of the Act, enables directors to obtain access to board papers to enable them to consider whether their colleagues on the relevant company board have been carrying out their duties and obligations in an appropriate fashion. The common law duty was considered in the case of *Edman v Ross* (1922) 22 SR (NSW) 351 (*Edman*). This decision demonstrates the willingness of the courts to provide a generous interpretation of that right to benefit those whose interests may be negatively affected by decisions made in relation to the company.

Recently, the Full Federal Court had to consider an interesting challenge to the claim by directors under the statutory provision. They were being denied access to the affairs of the company in the case of *Mesa Minerals Ltd v Mighty River International Ltd* [2016] FCAFC 16. In this case, the court examined the claims made by the minority shareholder/director in the relevant company to gain access to the board papers. The court ruled in favour of the minority director to be provided with access to the papers of the company. It is unnecessary for our purposes to delve into the detailed discussion of the various issues that arose in the particular case, but the litigation occupied a considerable period of time.

It is important to note that the court had little difficulty in dismissing every objection raised by the defendant directors in challenging the right of the minority shareholder directors to obtain information to better assess the way the company was being managed, in pursuit of challenging the investments regarded as not being in the company's best interests.

Of course, obtaining information is but the first step in such a challenge – the litigation that enables the court to assess whether there has been a breach of duty or some oppressive or related conduct is the next important hurdle that has to be overcome.

In this context, it is interesting to compare the favourable consideration of the claim of the director to obtain access to the board papers, to the failure of shareholders in a company who wished to raise an important question at the annual general meeting (AGM) of the company. Certain hedge fund investors/shareholders wanted to raise for discussion at the AGM of the Commonwealth Bank of Australia (CBA) the policies behind the lending by the CBA of moneys to companies, which the shareholders alleged were engaging in activities that might have an environmental impact. The Australian Centre for Corporate Responsibility, the relevant shareholder, asked the CBA to include in the agenda for the forthcoming annual general meeting resolutions which would examine the impact of the loans made by the CBA to the companies that invested in projects which it was alleged affected the environment. The board of directors decided not to list the relevant resolutions for discussion. Justice Davies, in dismissing the action, relied not only on the general law that provides directors with the right to decide what matters should or should not be discussed at the AGMs, unless the constitution of the company provides otherwise, but also on the provisions of the Act.

Her decision in *Australian Centre for Corporate Responsibility v Commonwealth Bank of Australia* (2015) 325 ALR 736 was confirmed on appeal by the Full Federal Court in *Australasian Centre for Corporate Responsibility v Commonwealth Bank of Australia* [2016] FCAFC 80. Chief Justice Allsop, and Justices Foder and Gleeson, unanimously dismissed the lobby group's arguments and upheld the board's decision on the basis of the company's constitution and the provisions of the legislation. This decision demonstrates that in certain circumstances, relief to directors may be favoured over that of the shareholders. This will be especially so where the division of powers within a corporation, aimed at ensuring that the duties placed on directors in managing a company do not become overly burdensome, is regarded as a matter of prime importance.

Remedies for shareholders and members and other interested investors

The law provides a series of very generous remedies under the Act, as well as at common law, to shareholders (members) of companies if they want to challenge the actions of the directors, or the majority shareholders of companies, where they successfully argue that there has been a breach of duty on the part of directors or members, or any oppressive behaviour. The statutory derivative action, contained in ss 236 and 237 of the Act, has provided significant simplification for shareholders in bringing actions in the name of the company in order to challenge the actions that may be the subject of dispute. After a few early stumbles by shareholders and others relying on the statutory derivative action, the success rate in more recent years has been impressive. In this section of the review we first consider recent cases dealing with the statutory derivative action; we then turn to discuss the remedy of oppression under ss 232 and 233 of the Act; and then consider a range of other issues impacting on remedies available to shareholders and others.

The statutory derivative action – ss 236 and 237 of the Act

The statutory provisions of ss 236 and 237 of the Act were one of the most significant corporate reforms in the first decade of this century. They were included in the legislation at the behest of the then treasurer, the Honourable Peter Costello, as a "balancing provision" to the enhancement of directors' duties in s 180 and related provisions. As noted earlier, the courts took some time to provide support for the statutory derivative action.

The relevant statutory provisions contain a number of hurdles which need to be overcome by shareholders who wish to bring an action in the name of the company. They relate to some technical matters but also to more fundamental questions – is the relevant legal action in the best interests of the company, and is it likely that the legal action will succeed? A number of cases in early years have denied the ability of shareholders to bring statutory derivative action because one or both of these matters had not been adequately addressed by the plaintiffs.

As also noted earlier, the early failures met by shareholders have now been balanced out by a succession of highly impressive actions in which the statutory derivative action has been used to the advantage of shareholders. We have discussed a number of these cases in previous years in our Annual Reviews of Corporations Law. An important case in 2016 was the New South Wales Court of Appeal decision in *Huang v Wang* [2016] NSWCA 164. This decision confirmed the original decision by Black J in the Supreme Court at first instance in *Huang v Wang* [2015] NSWSC 510. The relevant action was brought about by one of two "partners" in a company known as Ismile Dental Pty Ltd (Ismile). In his decision at first instance, Black J ruled that it would not be in the best interest of Ismile for the litigation to be able to proceed because the parties were seeking the ruling that a constructive trust existed in the relationship between the parties in order to seek a result.

The facts of the case, which were also relied on heavily by the Court of Appeal, were as follows:

> Dr Huang, who was the principal shareholder in Dr Huang Enterprises Pty Ltd (DHE), and Dr Wang, who was the principal shareholder in WW Enterprises NSW Pty Ltd (WWE), were dentists who decided to form the company Ismile. Under the terms of this relationship both doctors operated separate practices, but had some shared expenses. Ismile was structured so that each dentist could keep the profits from their own patients. Ismile was the trustee of Ismile Dental Trust. Under the terms of this trust both DHW and WWE earned an equal number of units. The trust deed provided that the trustees were able to accumulate income with the consent of the majority of ordinary unitholders. The trust deed also conferred wide powers on the trustees (this included the power to invest in property and borrow).

The relevant dispute before the courts arose because Dr Huang claimed that the action taken by Dr Wang in purchasing the rented premises where he, Dr Wang, practiced, using loan monies and other advantages, arose out of a course of conduct that represented a breach of Dr Wang's fiduciary and statutory duties owed to the joint venture company Ismile. It was claimed that Dr Huang had diverted the company's opportunity to purchase the premises on behalf of Ismile; instead she brought it in her own company's interests.

Black J ruled that there was no breach of the relevant duties owed by directors in the relevant circumstances.

On appeal it was argued that Black J had erred in his interpretation of the facts and the discretion available to the court under s 237 of the Act.

Further, the appellants claimed that Black J had asked the wrong question at the trial, by stating that the court was required to determine whether it was in Ismile's "best interests" to grant leave to bring proceedings.

The appeal was heard and dismissed by Chief Justice Bathurst, Justice of the Court of Appeal McColl and Acting Justice of the Court of Appeal Barrett. A number of cases were referred to by the members of the Court of Appeal. Bathurst CJ, delivering judgment on behalf of the Court of Appeal, noted the following and very interesting remarks:

> Section 237(2) provides for five criteria for the grant of leave. It is well established that if these criteria are made out, the court is required to grant leave and conversely, if anyone is not made out, the court should refuse leave (at [57]).

His Honour further clarified at [58] and [61] that the decision the court had to consider was not really a discretionary one; rather, it was necessary for the court to be satisfied that the relevant legal proceedings were in the best interests of the company. This could only be determined by the court, taking into account all the relevant facts in the case.

Of the cases referred to in the major judgment, the decision in *Chahwan v Euphoric Pty Ltd* [2006] NSWSC 1002 was perhaps the most important. Additionally, the Court ruled that it was appropriate to question whether the granting of leave to bring proceedings seeking non-conditional relief under s 237 of the Act was in the best interests of the company. In dealing with this particular point, Bathurst CJ provided these short but relevant comments:

> [The trial judge's] ultimate conclusion was that he was not satisfied that it was in the best interests of Ismile to bring the proceedings where the evidence did not support its ability to do equity to obtain such relief. There does not seem to me to be any error in this approach (at [64]).

This decision is the most interesting one during the course of the year. There is a further decision, this time that was successfully brought by the relevant complaining minority shareholder, namely *Daiwa Can Company v Barokes Pty Ltd* [2016] VSC 296. The minority shareholder had failed in a preliminary hearing in *Knights Quest Pty Ltd v Barokes Pty Ltd* [2015] VSC 601 when all the facts were not before the court. On the rehearing, before Sifris J, the primary facts were that Stokes, who had become a director of a company Barokes Pty Ltd (Barokes), brought proceedings in Japan against the company Daiwa Can Company (Daiwa), alleging that there had been a failure on the part of the major shareholders and directors in the company to promote the interests of the company, rather than promoting the interests of individual shareholders. In the view of Sifris J, Stokes (suing as a shareholder of Barokes and on behalf of the company Knights Quest Pty Ltd (Knight's Quest)) had satisfied the good faith requirement that the relevant shareholder needs to establish under s 237(2)(c) of the Act to enable the litigation to proceed.

Sifris J noted a long line of authority affirming the decision of Justice Palmer in *Swansson v RA Pratt Properties Pty Ltd* [2002] NSWSC 583 (*Swansson*) that the courts will have regard to two factors when considering whether the good faith requirement had been satisfied. Justice Sifris quoted Palmer J, saying:

> The first is whether the applicant honestly believes that a good cause of action exists and has a reasonable prospect of success. … The second factor is whether the applicant is seeking to bring the derivative suit for such a collateral purpose as would amount to an abuse of process (at [38]).

Interestingly, although Sifris J acknowledged that there were broader issues and disputes at play with all the relevant parties engaging in different tactics, his Honour did not consider that the Japanese proceedings were being conducted for a collateral purpose in the relevant sense. This was notwithstanding the fact that a favourable outcome in those proceedings would benefit Knights Quest. He explained, further quoting *Swansson*:

> [W]here the application is made by a current shareholder of a company who has more than a token shareholding and the derivative action seeks to recover property so that the value of the applicant's shares would be increased, good faith will be relatively easy for the applicant to demonstrate to the courts satisfaction (at [40]).

In Sifris J's view, a further factor to take into account was the costs and benefits in allowing the proceedings to proceed. Referring to the decision of Justice Austin in *Fiduciary v Morningstar Research* [2005] NSWSC 442, Sifris J stated that in this case:

> It is in the best interests of the company as a whole, apart from, but obviously consisting of, its rival factions, that the ongoing bitter dispute between its shareholders be resolved. Resolving a deadlock situation is obviously in the best interests of Barokes (at [82]).

Often, the statutory derivative action is brought at the same time as an action relying on the oppression remedy. We shall see this as a relevant matter considered in the next section of this remedies review in the discussion of the decision in *Re B Personal Pty Ltd* [2016] VSC 211. The fact that statutory remedy is also erased does occur in other cases as well.

The concluding comments of Sifris J, where he noted that a court does not normally resolve the dispute in answering the question where the threshold for bringing the action under ss 236 and 237 is being satisfied, demonstrated that it was preferable for the court not to express any view on the relevant strengths and weaknesses of the particular claims. In the relevant case, Sifris J ruled in favour of the applicants and noted that a different result might arise in different situations:

> [t]he Court does not resolve the dispute but merely exposes and identifies its existence and then determines whether it is serious or frivolous. Further it is not the function of the Court and it is preferable that the Court not express any view on the relative strengths and weaknesses of the respective claims (at [90]).

In an interesting judgment, which was quite short but provided a clear explanation of the principal issue surrounding the interpretation of s 237, Sifris J ruled in favour of the applicant and made clear that there can be very different views reached in cases of this kind. What is of even greater interest is the increasing use of statutory derivative action, justifying the then Government's decision to introduce this significant change to our law some 16 years ago.

The oppression remedy

The oppression remedy is one of two of the most important statutory remedies that are available to shareholders (members) of companies and continues to present opportunities for challenging the decisions of directors if the regulator, ASIC, or other persons, do not intervene in the appropriate way. Earlier, we discussed the increased success of reliance on the statutory derivative action (see ss 236 and 237 of the Act).

In the 2014 Annual Review, we highlighted the significance of the decision in the Victorian Supreme Court case of *Ubertini v Saeco International Group SpA (No 4)* [2014] VSC 47 (see pages 28–29). For some years, it had been thought that the oppression remedy would only be relevant for disputes between shareholders and private or closely held companies, but over the years the oppression remedy has been used in public companies or companies with a broader shareholding.

The most interesting cases in 2016, which once again illustrated the importance of the remedy in companies where there is a more widely held group of shareholders involved, or where the issues concern matters in the "public domain", are the decisions in the Federal Court with respect to the operations of the Queensland sugar industry. The Full Court of the Federal Court of Australia in *Mackay Sugar Ltd v Wilmar Sugar Australia Ltd* [2016] FCAFC 133 confirmed the ruling earlier in the year by Yates J in *Wilmar Sugar Australia Ltd v Queensland Sugar Ltd (No 2)* [2016] FCA 180, that an oppression action brought by Wilmar Sugar Australia Ltd (Wilmar) against the defendant company Queensland Sugar Ltd (Queensland Sugar), with respect to its reorganisation of the constitution so as to limit the power of individual shareholding companies within the sugar industry in Queensland in order to participate in governance and related matters, amounted to oppression (as prescribed by s 232 of the Act).

There has been ancillary litigation in which Wilmar has tried to limit the ability of Queensland Sugar to amend its constitution (articles of association) in a way which Wilmar argued was too restrictive. In the decision of Greenwood J in *Mackay Sugar Ltd v Wilmar Sugar Australia Ltd (No 2)* [2016] FCA 1179, Wilmar challenged the revised amendments to the constitution of Queensland Sugar; reflecting the difficulties that courts will face in dealing with the intricacies of the amendments to corporate constitutions in appropriate cases. It is unnecessary, for our purposes, to discuss those ancillary cases. The thrust of this overview is to emphasise that the remedy under ss 232 and 233 of the Act remains very broad and important.

The central question in the relevant dispute revolved around the attempt by Queensland Sugar to amend its constitution so as to limit the ability of organisations that were required to work together under the initiatives taken by the Queensland Government. These were aimed at enhancing the role of Queensland Sugar's operations as the main body to provide appropriate support and efficient decision-making for the Queensland sugar industry. The proposed changes were in effect an attempt to limit the ability of corporate shareholders voting in particular ways which might impact the governance of the relevant organisations. It was argued by Wilmar at first instance that the proposed amendments, although they may have created a more effective and efficient regulatory framework, were interfering with the rights of members of the overall organisation, and as such the changes amounted to oppressive, unfairly prejudicial or discriminatory conduct.

Yates J, in a comprehensive decision, confirmed the claim by Wilmar. His judgment relied heavily on a broad reading of the oppression remedy based on earlier cases such as *Wayde v NSW Rugby League Ltd* (1985) 180 CLR 459 (*Wayde*) and similar cases. The Full Federal Court ruled that Yates J was correct in interpreting the law and that these amendments were unnecessarily restrictive changes being made to the constitution of the company, which meant that the rights of the individual shareholders were being subjugated to a less significant role in the running of the company than was warranted. As noted earlier, the decision of Yates J relied heavily on earlier decisions in which the oppression remedy had been interpreted more broadly by our courts. The Full Federal Court confirmed the reliance on these earlier decisions which, apart from the decision in *Wayde*, also embraced the approach taken by the High Court of Australia in the decision in *Campbell v Backoffice Investments Pty Ltd* (2009) 238 CLR 304.

This approach to the interpretation of the oppression remedy was one that was clearly supported by a quite different case, one involving a small company where a family dispute was the centre of the consideration, namely *Re B Personal Pty Ltd* [2016] VSC 211. Brothers Johann and Shane Bilsborough were the only directors of a family company. Shane and his wife each held 25% of the share capital in the company whilst Johann held the remaining 50%. The brothers also formed a business called Global Corporate Challenge (GCC). Forty-five per cent of the shares in this company was held by B Personal; the remaining 55% was held by a marketing company and related organisation.

The defendant was appointed to the board of GCC, and he and his wife were instrumental in ensuring that the business of that company was maintained. The defendant also controlled another company (SB Group) and used his position as a director of B Personal to divert payments and opportunities to SB Group. The plaintiff argued that this was a wrongful use of opportunities that belonged to the company and that the action amounted to oppression. The defendant in turn argued that the opportunities and payments were to compensate him and his wife for the services they provided to GCC.

Robson J, after considering the relevant facts, held that there had been oppression (as defined by the legislation). In his view, the interests of the members of the company as a whole had been disregarded by Shane (and presumably his wife) in the way he had conducted his position as a director.

A number of cases were referred to by his Honour, including *Sanford v Sanford Courier Service Pty Ltd* (1986) 10 ACLR 549, and in particular the leading decision in *Scottish Co-operative Wholesale Society Ltd v Meyer* [1959] AC 324. Whilst statutory derivative relief was also sought, Robson J ruled that it was irrelevant.

One interesting comment made by Justice Robson was that the dispute may have been better resolved by the brothers if they had taken a different share of dividends to reflect their respective contributions in the running of the company. Nevertheless, in the absence of any such action or guidance, the oppression remedy may prove to be a useful remedy as it was found to be in this case.

A number of other decisions during the course of the year showed the vitality of the remedy. See for example *Strategic Management Australia AFL Pty Ltd v Precision Sports & Entertainment Group Pty Ltd* [2016] VSC 303 and *Re Bideena Pty Ltd* [2016] NSWSC 735. A most unusual case, but one which again reflects the flexibility of the remedy, caused the decision of the New South Wales Supreme Court in *Walker v New South Wales Bar Association* (2016) 114 ACSR 269, which denied the claim by a barrister, who had not been appointed a senior counsel in New South Wales, dismissing her claim that the decision was oppressive, unfairly prejudicial to, or unfairly discriminatory against her.

Miscellaneous cases of interest

There have been many interesting cases in other areas of the law than the ones that we have covered in the two previous larger sections.

In particular, class actions which are being brought as a result of alleged traders on the part of directors and others have formed a significant area of interest, and it is useful to review the way the courts have dealt with these cases and in particular issues surrounding the difficulties that arise in class actions and related matters.

Significant increase in class actions involving losses by investors and others

When the High Court of Australia decided to allow the use of litigation funding in Australia (see the case of *Campbells Cash and Carry Pty Ltd v Fostif Pty Ltd; Australian Liquor Marketers Pty Ltd v Berney* [2006] HCA 41), this opened the door to potential class action litigation. The rules of the Federal and State Supreme Courts (not all of the States, with Queensland set to include a class action structure into its legal system in the coming months) had allowed class action litigation to be brought under fairly strict rules. The year 2017 will be the 25th anniversary of the introduction of class action litigation in Australia.

For many years, although class action litigation has been heavily used in cases in traditional areas of tort law, they had been sparingly used in litigation involving losses by shareholders. However, in recent years there has been a significant increase in class action litigation brought by litigation funders on behalf of persons who have alleged to have suffered significant losses as a result of investing in shares and other financial products.

Until 2016, the ability of persons who had suffered losses as a result of investing in company securities was limited by the need to show a direct connection between their investment and the relevant false, misleading or deceptive statements issued in the market space by the various companies. Perhaps the most significant decision in which such losses, amounting in the hundreds of millions, were rejected, was in the initial litigation arising out of the Babcock & Brown collapse. In its very high-profile collapse in the second decade of this century, during the global financial crisis, Babcock & Brown found itself exposed via capital-intensive parts of its business model, which brought the company down with the share price falling from $34.63 to just $0.33. This left investors looking for answers in the courts. Ultimately it was found that Babcock & Brown directors had not breached their duty as they were found to be unaware that the investment bank was insolvent in November 2008 when the company was failing. Therefore, the directors were not responsible for non-disclosure of that information to the investors.

In the Federal Court case, Justice Perram cast some serious doubts on the reach of the continuous disclosure provisions of the Act in situations where investors are essentially trying their luck in buying shares in mining and other speculative stocks and securities. One of the key arguments running in the Babcock & Brown litigation over the years was the claim by shareholders that they could rely on a US litigation strategy known as "fraud on the market", which has been highly successful in the USA in underpinning huge damages recoveries in that country. The argument was one that was continually rejected, most recently by the full Federal Court in *Caason Investments Pty Ltd v Cao* (2015) 236 FCR 332; [2015] FCAFC 94. In that case, however, Edelman J dissented, and suggested that the earlier litigation in the Babcock & Brown litigation should have allowed the "fraud on the market" argument to succeed.

Most recently, however, Brereton J in *Re HIH Insurance Ltd (in liq)* [2016] NSWSC 482 (*HIH Insurance*) accepted the proposition that the "fraud on the market" argument could be utilised. Indeed in his decision, on the basis of the relevant arguments put to the court, Brereton J ruled that the argument was one that should be accepted as a viable one for the purposes of the litigation before him. The decision was met with doubts, mainly from the Australian legal market, but so far there has been no attempt to challenge that decision and nor was there any appeal brought from the decision of Brereton J in that case.

That particular argument has certainly been one of the highlights in relation to class action litigation, but there have been many other fascinating legal and other challenges in the class action litigation area. One of the more interesting "skirmishes" arose following claims made by a company, Melbourne City Investments Pty Ltd (MCI) which attempted to buy out minority shareholder interests in a range of companies in Australia.

In Melbourne City Investments Pty Ltd v Treasury Wines Ltd [2014] VSC 340, Ferguson J in the Victorian Supreme Court made important observations concerning potential conflicts that may arise where the solicitor, acting on behalf of the securities class holders, was also a member of the securities class holders and was in fact the sole director of the shareholder company that was involved. She was concerned that there could be a clash of interests in the lawyer's representation at these two levels.

Many other actions brought by MCI have failed. The Victorian Court of Appeal in *Treasury Wine Estates Ltd v Melbourne City Investments Pty Ltd* [2014] VSCA 351 ruled that the particular proceedings brought to obtain damages were not ones that the court should entertain. The court ruled that the litigation was not being brought as a genuine class action. In later proceedings, Foster J ruled that the particular litigation which was brought in the Federal Court in *Melbourne City Investments Pty Ltd v Treasury Wine Estates Ltd* [2016] FCA 787 should be stayed as an abuse of process. In doing so, Foster J held that the genuine reason for the relevant litigation was not to ensure that the shareholders would succeed, but rather that Mr Elliott (the sole director, secretary, and shareholder), and other persons behind the organisation of MCI, would gain personally.

It is likely that this litigation will continue. Perhaps a special leave application may be made by a court to eventually deal with these matters. The litigation is continuing in this particular "contest" and it will be fascinating to see where it eventually finishes up. In the meantime, MCI has not been particularly successful in the class action strategies that it has been pursuing.

Arguments have continued as to the need for further controls in the context of class actions being run in the courts. The courts have been insistent in trying to control the use of class actions and earlier judgments, such as early litigation involving Storm Financial Ltd in *Australian Securities and Investments Commission v Storm Financial Ltd (Receivers and Managers appointed) (in liq) (No 2)* [2011] FCA 858. In the courts' view, the use of class action strategies is an appropriate utilisation of available mechanisms in the litigation system. It is not necessary to discuss these cases, as none of them have run through to finalisation. Most have been settled and there have been considerable amounts of research undertaken by Professor Vince Moribito (Department of Business Law and Taxation, Monash Business School) on the pattern of litigation in the class action scenario (see Professor Moribito's Fourth Report titled "An Empirical Study of Australia's Class Action Regimes – Facts and Figures on Twenty-four Years of Class Actions in Australia" (August 2016).

One of the more significant questions that the courts have had to face in the area of class action has been the appropriate sharing of damages recovered in litigation between different classes of investors or plaintiffs who have suffered loss. A recent decision of Murphy J in *Kelly v Willmott Forests Ltd* (2016) 112 ACSR 584; [2016] FCA 323 (*Willmott Forests*) centred on just how the different class members involved in this piece of litigation should be treated in the settlement arrangements that were reached. In this case, Murphy J considered the very significant question of how the different views of class members, especially if there are also different classes of members involved (and in certain cases a number of class actions can be brought in respect of the same alleged loss), were being catered for by the parties. His Honour clearly explained that any settlement reached by the parties must be "fair and reasonable" to all, even those who may have "opted out" of being involved in the litigation.

In reaching his final conclusion, Murphy J embraced the criteria that had been laid down in the case of *Williams v FAI Home Security Pty Ltd (No 4)* (2000) 180 ALR 459 in which the court discussed the criteria that was necessary to be considered in such a situation. In *Willmott Forests*, Justice Murphy embraced as relevant criteria when determining "fairness" of a settlement, by reference to these matters:

> (i) the amount of settlement offered to each class member; (ii) the prospect of the litigation succeeding; (iii) the likelihood of class members obtaining an amount significantly in excess of the settlement offer; (iv) any terms of advice received from counsel or independent experts; (v) the likely duration and cost of the proceeding; and (vi) the attitude of the class members to the settlement.

US litigation was also considered by Justice Murphy in this very interesting decision, which is another one of the increasing number of class action cases that are likely to be brought to a High Court for further consideration.

Judges have continued to question the absence of appropriate rules in dealing with issues arising in class action litigation, and there have been continued calls for a more structured rule-making process to be introduced in this context. It is unclear whether that particular matter can be taken up successfully as there are different class action regimes at the Federal level and at the various State Supreme Court levels.

Liability of a holding company for debts of a subsidiary

Whilst there have been no decisions in Australia on this particular question recently, the New Zealand Court of Appeal in *Steel & Tube Holdings Ltd v Lewis Holdings Ltd* [2016] NZCA 366 had to consider an argument that quite often comes before the court: is a holding company liable for the debts of its solely owned subsidiary or controlled subsidiary in special circumstances? It is useful, in this context, to set out briefly the facts of the relevant case and the Court of Appeal's decision.

Lewis Holdings Ltd (Lewis) leased a property to Stube Industries Ltd (Stube), a wholly-owned subsidiary of Steel & Tube Holdings Ltd (STH). The lease expired in 2009 but was renewed for a further 21 years. STH paid the rent and other expenses relating to Stube's lease until 2013. Stube was placed into liquidation in July 2013 and liquidators of Stube disclaimed the relevant lease, leaving Lewis out of pocket. Lewis proceeded to seek orders under s 271 of the *Companies Act 1993* (NZ) (the Act). This provision sets out an exception to the general principle that a subsidiary company is a legal entity separate from its parent. At first instance the court held that it was just and equitable to make STH liable for the debts of the subsidiary (see *Lewis Holdings Ltd v Steel & Tube Holdings Ltd* [2015] 2 NZLR 831).

The Court of Appeal upheld the trial judge's decision. The court was not persuaded by arguments raised by the holding company that the judge was wrong in evaluating the facts and the nature of the relationship. In its view, s 271(1)(a) of the New Zealand legislation provided sufficient guidance to the court to enable it to show that the subsidiaries' commodities activities had been "absorbed into STH without consideration given to its separate corporate personality and the ongoing representations by STH", and that the holding company stood behind the relevant debt incurred by this subsidiary. This does not mean that STH should have been treated as a separate new entity; rather, in the circumstances, the guarantees provided gave the courts sufficient leverage to make the public company liable for the debts or the operations of the subsidiary.

This decision is an unusual one. Australian courts tend not to rule in favour of claims making the holding company liable for the debts or actions of subsidiaries, but special circumstances, and special statutory provisions in certain situations, may warrant such a decision being taken.

The insolvent trading dilemma

Earlier in this review, we discussed attempts to improve the ability of directors to obtain "immunity" from the insolvent trading provisions of the Act when they made genuine attempts to rescue companies from liquidation or a similar fate.

However, insolvent trading is regarded as a major area of concern by ASIC. In that context, it is unusual to see directors being sued criminally in relation to such breaches. A recent important example of this approach is the Queensland decision (as yet unreported) in the case of *Kleenmaid* (see ASIC Release 16-257 MR). The managing director of the Kleenmaid organisation, EDIS Service Logistics Pty Ltd, was accused by ASIC of obtaining funds from the Westpac Banking Corporation in order to acquire inventory, even though he had full knowledge of the dire financial position of his company, and made no effort to inform the bank of its position, eventually owing upwards of $13 million when the company collapsed. Justice Farr stated that the director was well aware of his duty not to trade while insolvent and nevertheless showed a "callous disregard for the future of those affected … risking other people's money in extraordinary amounts". The Kleenmaid director was found guilty and sentenced to nine years imprisonment for his actions.

It is unlikely that moves to soften the operation of these provisions will succeed in general terms. Certainly, the Productivity Commission in its Business Set-up Report did not encourage any softening of the current stance against insolvent trading. Nevertheless, bodies such as the Australian Institute of Company Directors and other legal bodies continue to argue for a broader business associate rule to the one contained in s 180(2) of the Act. The Treasury Report discussed earlier will only alleviate concerns that are a very narrow area of business transactions.

Setting aside default judgments winding up companies on the basis of default

One of the more important sections available to creditors under the Act is s 459G. This provides a speedy way for creditors to seek the winding up of a relevant company without having to go through a long litigation process. However, from time to time, but rather rarely, the courts have set aside default judgments obtained in this fashion. An interesting recent case in that context is *Ligon 158 Pty Ltd v Huber* [2016] NSWCA 330.

In that case, the New South Wales Court of Appeal set aside such a default judgment (see the decision of Brereton J in *Ligon 158 Pty Ltd v Huber* [2016] NSWCA 330). It is unnecessary to discuss the facts of the case other than to note that they were challenged in the New South Wales Court of Appeal. The court ruled that there had been an error made by the trial judge in evaluating the evidence and the facts and set aside the winding up order. In particular, Barratt AJA noted (supported in this view by McColl and Meagher JJA) as follows:

> It cannot be said that the proposition that the (relevant owner of the company) Ms Huber made a non-refundable contribution as distinct from a loan is so devoid of plausibility as to warrant further investigation … The only question of whether *Ligon 158*'s case, based on a non-refundable contribution, is so lacking in substance that it can be dismissed without further examination. The primary judge erred in giving a positive answer to that question (at [84]).

The court set aside the winding up order on the basis that it was not supported by any evidence.

In contrast, and more recently, the Victorian Court of Appeal reached a different conclusion in the case of *GoConnect Ltd v Sino Strategic International Ltd (in liq)* [2016] VSCA 315. In this case, the court held that the applicant had not made out a strong enough case to overturn the original decision of the trial judge. In doing so, the court relied on principles enunciated in *Malec Holdings Pty Ltd v Scotts Agencies Pty Ltd (in liq)* [2015] VSCA 330. In that case, the court held that any challenge made to set aside the ruling in the winding up, must "fairly notify" the relevant parties of the evidentiary basis for a submission that the statutory demand should be set aside on the particular ground upon which the applicant seeks to rely (see in particular [59] and [62]).

The Clive Palmer investigation

One of the more interesting developments in 2016 has been the continued examination by officials surrounding the collapse of the company Queensland Nickel Pty Ltd (Queensland), in which Clive Palmer was a principal investor.

In the report by the official administrator of the company, FTI Consulting, once it entered into administration, suggestions were made that perhaps Clive Palmer had acted as a shadow director of the company at the time that insolvency was imminent.

The question of whether Clive Palmer was a shadow director will be the subject of a very interesting consideration on completion of the investigations. Whilst there have been no recent cases on the matter of shadow directors, in *Buzzle Operations Pty Ltd (in liq) v Apple Computer Australia Pty Ltd* (2010) 238 FLR 384 (*Buzzle*) interesting guidelines are presented on when a shadow directorship may be said to exist.

It is too soon to comment further on this particular prospect. It is interesting to note, however, that Clive Palmer has tried to stall the relevant examination proceedings. He sought leave from the High Court to challenge the process. His application to the High Court failed. See *Palmer v Ayres, Parbery and Owen as liquidators of Queensland Nickel Pty Ltd (in liq); Ferguson v Ayres, Parbery, Owen as liquidators of Queensland Nickel Pty Ltd (in liq)* [2016] HCA Trans 265, where Palmer was denied leave to proceed further.

Commissioner John Price of ASIC has continued to express interest in the investigations being conducted in this matter and it would be fascinating to see the final conclusions once that process has been completed.

Conclusions

During 2016 we have seen, as noted earlier, a significant number of cases in our courts discussing matters relating to directors' duties and issues linked to those issues. There have also been interesting cases discussing the remedies of members (shareholders) and the remedies available to them through statutory provisions (the statutory derivative action, the oppression remedy) as well as common law remedies. Class actions continue to remain a very significant part of our law and 2017 marks the 25th anniversary of the introduction of class actions in Australia. Herbert Smith Freehills will be launching a new book on this topic, edited by Damian Grave and other professionals, which will be launched in March 2017.

Other reforms in the law are being considered. However, the federal government has still not set up in place of CAMAC, a law reform body to deal with questions in this and related areas of the law. This is particularly regrettable because during 2017 we will see an increased agitation for the introduction of important legislation to strengthen the current whistleblowing provisions of the law, which we discussed briefly in this review. The amendments accepted in the *Fair Work (Registered Organisations) Amendment Act 2014* (passed on 22 November 2016) introduced important whistleblowing provisions which broadened the definition of who is eligible to make disclosure in this context. These amendments, which will provide protection to whistleblowers in a manner not previously seen in Australia, will build on current provisions in the Act. The Griffith University Centre for Governance and Public Policy is leading a multi-university research project that is assessing the introduction of a broader whistleblowing process regime for the public sector, businesses and not-for-profit organisations in Australia and New Zealand. The project – entitled "Whistling While They Work" – seeks to highlight areas for policy and law reform as well as providing advice to persons and organisations interested in whistleblowing.

The year 2017 will see significant changes to the law regarding the investment sought by companies from the public in line with the recommendations made by the Murray Report into financial institutions. As noted earlier, the Assistant Treasurer has recently announced that some of the new powers that ASIC will enjoy in relation to the implementation of the Murray Report are the subject of discussion papers published by Treasury. ASIC is now seeking submissions from the public. ASIC will receive increased funding in order to carry out these new tasks, but one should not be surprised that there may be some interesting submissions made to challenge the new powers to be vested in ASIC and the new responsibilities that will be provided to ASIC. In addition, we await with interest the potential reviews of cases, such as the decision in *Cassimatis* amongst others, which have certainly raised important statements of principle in relation to the duties of directors.