ANNUAL REVIEW OF CORPORATE LAW 2020

by

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INTRODUCTION

Welcome to the Corporations Annual for 2020, which marks 15 years since this publication began in 2004. In the annual review last year, I wrote that 2018 had been a year where corporate law had dominated the media headlines, and this has been repeated in 2019. The fallout from the Hayne Royal Commission has caused a re-evaluation of many areas of corporate law and regulation, as well as spurring on numerous law reform initiatives (with more to come in 2020).

The scope of legislative change has been broad in the past year, with significant changes to the civil and criminal penalty regime in the Corporations Act as well as a range of new powers for ASIC (including product intervention powers). There are similar changes planned for 2020 with pending legislation making its way through the parliament (discussed below).

The case law on corporate law has continued to flow, although litigation arising out of conduct revealed in the Royal Commission will take some time to filter through the courts. ASIC has responded to the Royal Commission's recommendations to get tougher on misconduct by obtaining tougher civil and criminal penalties in the Corporations Act and being very public about the increased numbers of investigations and litigious matters it is undertaking which will no doubt be a feature of this review in the 2021 edition. Some key takeaways from the Royal Commission Final Report are discussed below.

The Hayne Royal Commission has given corporate Australia, and corporate lawyers, plenty of food for thought. While some will no doubt seek to minimise the significance of the Commission's findings on the basis that it was focused on misconduct in financial services and "that can't / won't / doesn't happen in my industry", that would be a short-sighted approach. The Final Report offers significant guidance on how boards work with management, how they approach and manage non-financial risks, and how compliance is dealt with in both small and large organisations. These are lessons for all boards, not just big banks and insurers.

LEGISLATION

Major legislation passed

Treasury Laws Amendment (Strengthening Corporate and Financial Sector Penalties) Act 2019 (Cth)

This Act reshapes the operation of civil and criminal penalties under the Corporations Act, including increasing maximum penalties, changing the way criminal penalties are calculated, introducing a new relinquishment order and extending the scope of civil penalty provisions. The Act also introduces new liability for the attempted contravention of a civil penalty provision and liability for being involved in the contravention of a civil penalty provision.

Treasury Laws Amendment (Design and Distribution Obligations and Product Intervention Powers) Act 2019 (Cth)

This Act introduces a new product intervention power for ASIC and imposes new obligations on the design and distribution of certain financial products. The Act amends the Corporations Act by imposing further duties and obligations on issuers and distributors of financial products that require a product disclosure statement (PDS) and securities that are regulated by Ch 6D. The primary obligation is to require a "target market determination" be formulated and regularly reviewed by the issuer. The issuer must not issue securities or financial products that are no longer consistent with the target market determination. The Act also enables ASIC to make orders about financial and credit products (the intervention power) in Pt 7.9A. ASIC proposes to use these powers in relation to certain over-the-counter (OTC) derivatives and released consultation on using the power in relation to add-on financial products through caryard intermediaries.

Treasury Laws Amendment (Enhancing Whistleblower Protections) Act 2019 (Cth)

This Act consolidates and broadens the existing protections and remedies for corporate and financial sector whistleblowers. This includes expanding the range of laws that can be subject to protected disclosures by whistleblowers, expanding who can receive protected disclosure, allowing former employees to act as whistleblowers and providing greater confidentiality and stronger immunities and protections against victimisation of whistleblowers.

Treasury Laws Amendment (Mutual Reforms) Act 2019 (Cth)

This Act amends the Corporations Act to clarify the operation of the Act to mutual entities, including the introduction of a new definition of mutual entity. The Act clarifies the operation of Schedule 4 of the Act and allows for mutual entities to issue mutual capital instruments.

Corporations Amendment (Strengthening Protections for Employee Entitlements) Act 2019 (Cth)

This Act substantially rewrites Pt 5.8A of the Act by setting out new penalties (including reducing the liability threshold) and recovery powers (including a new civil penalty provision) to deter behaviours that prevent, avoid or significantly reduce the recovery of employment entitlements in insolvency. The Act also introduces new disqualification powers to target directors who have been directors of multiple companies that have resulted in claims against the Fair Entitlements Guarantee scheme and where the scheme has failed to make substantial recoveries. There is also a new court power to make a "contribution order" against parties who have benefited from the employees' labour without paying market value. While this can extend to corporate groups, it goes beyond that to entities that are publicly associated or entities that are part of a single economic enterprise.

Corporations Amendment (Proprietary Company Thresholds) Regulations 2019 (Cth)

This amending regulation amends the *Corporations Regulations 2001* (Cth) to double the thresholds applicable for small and large proprietary companies in s 45A of the Act.

Pending legislation

Treasury Laws Amendment (Combating Illegal Phoenixing) Bill 2019

This Bill proposes to introduce new civil and criminal offences in order to discourage phoenix activity. The Bill does this by introducing a new concept of a "creditor defeating disposition" which will be inserted as s 588FDB and will centre on whether market value was obtained for the disposition of an asset where the disposition has the effect of hindering or delaying making the property available for creditors in a liquidation. The disposition will be voidable (under a new s 588FE(6B)) where the company was insolvent at the time, became insolvent due to the transaction or entered external administration within 12 months after the transaction. Those involved in or promoting creditor defeating dispositions may be subject to criminal sanctions and civil penalties, including a new duty (s 588GAB) to prevent entering into a creditor defeating disposition (although the safe harbour in s 588GA will be available as a defence). Significantly, ASIC is to be given a new power to issue an order that a creditor defeating disposition is voidable and that the transferee transfer the property to the company, pay an amount that represents the value of the benefit obtained and any detriment avoided by the transaction and/or any proceeds from the property. This is an extraordinary power that is based on s 139ZQ of the *Bankruptcy Act 1966* (Cth), but the proposed provision goes well beyond what the Official Receiver can do under that Act. There are serious concerns about the constitutional validity of this proposed power.

The Bill will also limit the ability of directors to back-date resignations and prevent directors from resigning where that would leave the company with no directors.

SIGNIFICANT CASES

CIVIL PENALTIES

LM Investment Management Ltd (rec apptd) (in liq) v Drake [2019] QSC 281

This case involved an application by a liquidator and receiver of a responsible entity (RE) that was being wound up. The application was for compensation against former directors of the RE for alleged breaches of duty involving the distribution of a settlement of litigation involving the RE. A custodian for the managed investment scheme (MIS) had made loans to a third party in order to develop property of the MIS. The plaintiff company (in addition to acting as RE of the MIS) was also trustee of an unregistered scheme, with the trustee also making loans to the same borrower. When the development was not completed the RE drew on funds from the unregistered scheme and sued the developer, which resulted in a settlement that the plaintiff distributed between the RE and the unregistered scheme. The case provides detailed consideration of the duties of REs and of officers of REs, including a discussion of the nature of the duty to act in the interests of scheme members. The case is of broader interest than duties owed in the MIS context because it also considers the nature of s 1317H, particularly how causation of damage is to be assessed (by holding that "common sense causation" from *March v E & MH Stramare Pty Ltd* (1991) 171 CLR 506; 65 ALJR 334; [1991] HCA 12 is not included in assessing s 1317H). The court held that the plaintiff had not proved that the directors' conduct in deciding on how to distribute the proceeds of the settlement, based on expert advice, constituted a breach of the duty of care in the circumstances.

ASIC v Helou [2019] FCA 1634

This case involved the failed attempt by the former CEO and CFO of Murray Goulburn to have ASIC's proceedings seeking disqualification relating to defective disclosure by the company thrown out on the basis that ASIC had conducted earlier proceedings against the company in respect of the conduct, and that the ACCC had also conducted proceedings. There is also an investor class action on foot relating to the conduct. The court rejected the arguments that ASIC's delay in bringing the proceedings against the individuals which resulted in an overlap between the various proceedings amounted to an abuse of process.

Schlegel v Gourmania Holdings Pty Ltd [2019] WASC 277

This case concerned a dispute between a former shareholder and director of Gourmet Chef Foods who sold his share to Gourmandia under deferred payment terms, but remained on the board. The former shareholder then authorised a pay increase and back pay for his role as director which the court held was a breach of his directors' duties. The company had purported to assign its rights to seek compensation under s 1317H and at general law to the shareholder (Gourmandia). The court held that the rights under s 1317H could not be assigned to a shareholder because it was a personal right given to the company, but the non-statutory fiduciary claims could be.

CONTINUOUS DISCLOSURE

ASIC v Vocation Ltd (in liq) [2019] FCA 807 (penalties decision: *ASIC v Vocation Ltd (in liq) (No 2)* [2019] FCA 1783)

This case concerned the failure of Vocation to update the market on the potential effects of regulatory action taken against it in Victoria. The board did not disclose the scope of effect of this action on the company's finances, and then specifically told the market that the action would not have a material effect on the company's finances. The company undertook a capital raising and advised the underwriter that the regulatory action would not have a material effect on the company. The court held that the company had engaged in misleading or deceptive conduct and had contravened continuous disclosure laws. Furthermore, the CEO, CFO and Chair had breached their duty of care in allowing the company to contravene disclosure laws. Importantly, the court applied the decision in *ASIC v Fortescue Metals Group Ltd* (2011) 190 FCR 364; [2011] FCAFC 19 where Keane CJ held that compliance decisions (eg whether to disclose information) were not business judgments and hence the statutory business judgment rule did not apply. ASIC did not seek orders against the directors in respect of being involved in the company's contravention of continuous disclosure laws under s 674(2B), instead relying upon the stepping-stones approach of using s 180.

TPT Patrol Pty Ltd v Myer Holdings Ltd [2019] FCA 1747

This decision is significant as a rare investor class action to go to full judgment. It also recognised indirect causation in investor class actions could operate (though it didn't in this case due to the finding of no loss), so that individual investors would not have to prove that they relied on the misrepresentations. The case concerned a failure by Myer to update the market on its profit projections. Interestingly, the court held that while the company should have updated the market once it had material information about the updated figures, but that the misrepresentation was unlikely to have caused loss because the accurate figures were similar to analyst projections and so the market had already priced in lower profit projections into the share price. The decision confirms that companies may engage in misleading conduct by failing to comply with continuous disclosure obligations in not updating the market with material information once the company becomes aware of it. The case also clarifies that where the material information is an opinion (such as whether the company will beat its profit projections) that was not actually held by the company, there is no obligation to disclose what the opinion should have been (ie that the company would not exceed its profit projections) until the company actually was aware of that information (ie by revising its profit projections). The case also reaffirms the importance of caution in making public statements on material information (such as answering questions in public briefings) before making an announcement through the ASX and the need to update the market when circumstances change even if analysts have factored in the changes.

Masters v Lombe [2019] FCA 1720

This case concerned actions by more than 1,200 shareholders in Babcock & Brown who claimed that the company failed to disclose revised earnings forecasts at a time when the company's share price had fallen substantially. The shareholders had had their proofs of debt rejected by the liquidator and appealed the decision to the court. The court held that the company did not need to disclose the information because the market had already priced it into the market price and that the uncertain nature of the company's circumstances could fit within the carve outs in ASX Listing Rule 3.1A. The court also acknowledged that market-based causation might be established in a particular case.

DIRECTORS' AND OFFICERS'

Hui v Champion [2019] FCA 1111

This case concerned a dispute between two groups vying for control of a company operating a farming business. One group had had their directors removed from the board and the directors argued that the conduct was in breach of directors' duties and that they could seek an injunction to reinstate them to the board under s 1324. The court rejected the application on the basis that it would circumvent the statutory derivative action.

Termite Resources NL (in liq) v Meadows (No 2) [2019] FCA 354

In this case the court held that directors had breached their duty of care and failed to act in good faith in the best interests of the company by failing to maintain an adequate cash reserve. Importantly, the court held that the duty to consider creditors was not limited to cases of actual insolvency, but rather (at [708]) "the duty of directors to consider the interests of creditors is enlivened when there is a 'real and not remote risk of insolvency' and when the objective circumstances require consideration of the interest of creditors."

The other significant decision on directors' duties in 2019 was the *Vocation* case, which was discussed above under Continuous Disclosure.

There were also several useful cases on the powers of directors and officers in 2019, including:

Akierman Holdings Pty Ltd v Akerman [2019] NSWSC 1486

This case involved a family company that required two directors to manage the business but where only one director (who was also a shareholder) undertook the role in the mistaken belief that his appointment as a working director (which entitled him to be paid a salary under the constitution) meant that he had sole authority to manage the company's affairs. A dispute arose between the director and the other shareholder (his sister) over the division of the company's property assets. The court held that the doctrine of unanimous assent validated the transactions even though the sole director lacked actual authority under the constitution. The case provides a detailed analysis of unanimous assent and the scope of s 1322.

Re Frigger [2019] FCA 1730

This case considered the scope for permission to manage a company (a company acting as trustee of a SMSF) while the directors were disqualified.

Wilh. Wilhelmsen Investments Pty Ltd v SSS Holdings Pty Ltd [2019] NSWCA 32

This case concerned the contractual liability of a company for the fraudulent actions of its IT manager. The IT manager had been introduced to customers by the former IT manager (who was leaving) as having the same role as the former manager. While the former manager had actual authority up to $10,000, the new IT manager did not have the same actual authority, but he then made almost 200 orders of mobile phones (worth almost $190,000) and misappropriated them. The supplier then sued the company for payment. The court held that the conduct of the former IT manager had clothed the new IT manager with ostensible authority and the company was bound by the contract.

FINANCIAL SERVICES

ASIC v Westpac Securities Administration Ltd [2019] FCAFC 187

This case provides a detailed analysis of the difference between general and personal financial advice. The bank had called customers to notify them of potential savings in merging superannuation funds to reduce fees and had believed that this was general advice rather than personal advice (which requires more attention to the customer's particular circumstances), but the Full Federal Court held that the calls were personal advice. The court also held that the bank failed to do all things necessary to ensure that the financial services covered by their licences were provided "honestly, efficiently and fairly".

INSOLVENCY CASES

Carter Holt Harvey Woodproducts Australia Pty Ltd v Commonwealth (2019) 93 ALJR 807; [2019] HCA 20

The facts in this case were discussed in the 2019 Annual Review. In summary, Amerind acted in the sole capacity as a trustee of a trading trust for business involved manufacturing and distributing decorative architectural finishes and panel products throughout Australia. It maintained a number of finance facilities with Bendigo and Adelaide Bank that were covered by security, including a debtor finance facility that allowed the bank to purchase Amerind's book debts.

The bank terminated all facilities and demanded repayment on 6 March 2014. Administrators and receivers were then appointed by the company and bank respectively. The administrators then became liquidators on 13 August 2014 following a resolution of creditors. The receivers traded the business for a short time and then wound it down, selling the stock and discharging the bank's secured debt. A surplus remained of approximately $1.6 million, which was subject to claims of competing creditors, namely the Commonwealth's FEG recovery program, who had paid $3.8 million to employees and Carter Holt Harvey (a supplier) who claimed security against the surplus. The receivers sought directions as to how to deal with the surplus. This gave rise to issues of whether s 433 applied to the surplus or whether it did not apply because the surplus was proceeds from the sale of trust property.

The High Court held that while the proceeds of the trustee's right of indemnity are property of the company and therefore s 556 applies, the use of the assets and proceeds from them remain subject to equitable limits because they are still assets held on trust (applying in substance the reasoning from *Jones v Matrix Partners Pty Ltd)* (2018) 260 FCR 310; [2018] FCAFC 40 (discussed in the 2019 Annual Review)). Therefore, the trust assets and their proceeds could only be used to satisfy trust creditors. In this case, the company only acted in its capacity as trustee and so there were only trust creditors. The outcome of this case resolves a long-standing issue about how to characterise trust property that is subject to the trustee company's right of indemnity and confirms that the statutory priority rules in ss 433, 556, 561 apply to the distribution of the property and its proceeds. The case also puts the final nail in the coffin of the decision in *Re Enhill Pty Ltd* [1983] 1 VR 561, by overruling it in favour of the decision in *Re Suco Gold Pty Ltd (in liq)* (1983) 33 SASR 99. However, the case does not mean that liquidators can avoid seeking appointment as a receiver for sale (by seeking to rely on statutory powers to sell the property of the company under s 477) nor does it address problems that arise when companies act in multiple capacities (such as acting trustee and non-trustee, or acting as trustee for multiple trusts), although Gordon J did offer helpful guidance on these issues.

Adelaide Brighton Cement Ltd v Concrete Supply Pty Ltd (Subject to DOCA) (No 4) [2019] FCA 1846

This case concerned a challenge to a DOCA, and provides a detailed summary of the various grounds in s 445D, particularly concerning the balance that an administrator needs to strike between investigations and reporting and the constrained time frames involved in voluntary administration. The case also considered whether the obligation to maintain adequate books and records (under s 286) was satisfied. The court held that a serious lack of records was not required to contravene s 286 and if a major transaction was not recorded then this was a breach of the provision.

Re Overgold Pty Ltd [2019] VSC 624

This case considered the issue of when a debt is incurred for the purposes of establishing insolvency. In this case, the court held that fees under a franchise agreement were incurred as debts at the time of entering into the franchise, not later when they fell due (in a similar category to rent under a lease). In this case, that was significant because it was not established that the company was insolvent at the time it entered into the franchise agreement.

TRANSACTIONS INVOLVING SHARE CAPITAL

Connective Services Pty Ltd v Slea Pty Ltd (2019) 93 ALJR 1079; [2019] HCA 33

This decision significantly expands the potential breadth in the meaning of "financial assistance". The case involved a prolonged dispute between the shareholders of a closely held company that operated a mortgage aggregation business. The principals involved in the business were involved in various court proceedings against each other and their associated companies. The company's constitution included a pre-emptive right to restrict transfer of shares to an outsider. Slea (which held approximately 30% of the shares) sought to sell its shares to an outsider and terminated the sale agreement in settlement of a dispute with the other shareholders. Slea then sought again to sell its shares to the same outsider (the sale agreement was discovered in other proceedings involving the company) and the company sought to enforce the constitutional right of pre-emption by seeking orders compelling Slea to offer its shares to the other shareholders. Slea sought a court order to stay the company's action on the basis that the agreement to sell the shares was identified during discovery and it would breach an implied undertaking not to use the discovered document for collateral purposes (which was upheld by the trial decision) and on the basis that court orders enforcing the pre-emption right would breach s 260A of the *Corporations Act 2001* (Cth). The High Court held that an injunction under s 1324 was appropriate as orders in the pre-emption proceedings could be characterised as financial assistance by the company. The company had failed to discharge its onus under s 1324(1B). The court said (at [39]):

> Section 260A(1) does not abrogate the power of a company to enforce its constitution. However, together with s 1324(1B), it has the effect that if a company wishes to bring proceedings to enforce pre-emptive rights in its constitution, for the benefit of some of its shareholders but at the company's expense, then the company is liable to be enjoined from doing so unless the assistance is approved by shareholders under s 260B, or unless the company can satisfy the court that bringing the proceedings at its own expense does not materially prejudice the interests of the company or its shareholders or the company's ability to pay its creditors. The Connective companies failed to discharge this onus.

MEMBERS' REMEDIES

Re ACN 091 518 302 Pty Ltd (in liq) [2019] VSC 699

This case concerned an application by a shareholder to bring a statutory derivative action to enforce the company's rights. The application was made both under Pt 2F.1A and under the court's inherent power to allow proceedings in the company's name. The court rejected both applications, but in doing so gave a detail summary of the law on derivative proceedings.

Re Scientific Management Associates Pty Ltd [2019] NSWSC 1643

This case concerned a company that operated businesses as a joint venture between the father of the plaintiff and the defendant. The shares were split 51/49 in favour of the plaintiff's father, but the defendant had extra votes attached to his shares and was also the governing director and so he controlled and managed the company's Australian businesses. The parties had entered into a shareholders' agreement. The defendant managed the company's businesses in Australia. When the father of the plaintiff died the defendant stopped complying with the shareholders' agreement and shut the plaintiff out of the business by refusing to appoint him to the board (as required under the shareholders' agreement). The defendant also refused to pay the applicant dividends that had been declared (despite paying himself dividends) and caused the company to extend him loans. The defendant also used the company's funds for private purposes, assigned irrecoverable loans to the company and transferred company assets to related parties at an undervalue. The court found that the conduct was oppressive under s 232 as well as being contrary to the interests of the members as a whole, and in so doing gave a detailed review of the scope of s 232.

Valra Pty Ltd v Mag Men Holdings Pty Ltd [2019] FCA 1897

This case concerned the operation of a shareholders' agreement that included a "drag along" clause that required the minority to sell their shares in certain circumstances. The minority complained that the operation of the clause was oppressive. The minority unsuccessfully argued that parties to a shareholders' agreement should be equated to partners. The case provides detailed discussion of the construction of shareholder agreements, including obligations to act in good faith. The court held that the drag along clause was not complied with because all shareholders were not given the same terms (although the same price was offered, some shareholders had further rights). However, this was not enough on its own to establish oppression. Furthermore, the minority shareholder could not establish loss and so the only order given was for a declaration of breach of contract.

Pacific Dairies Ltd v Orican Pty Ltd [2019] VSC 647

This case concerned a delisted public company involved in the dairy industry. The company had been losing money for several years and was suspended by the ASX for three years and then delisted. During the suspension new shares were issued to the directors at 1c per share. A group of shareholders requisitioned a meeting to vote on removing the directors, but when the company announced its AGM shortly after that the court held that the resolutions on the directors would be put to the AGM and no separate meeting was required. The court rejected claims by the plaintiffs that the company's consistent failure to execute on strategic goals constituted oppression, although the conduct "could be fairly criticised". The fact that the directors continued to act in the hope of improving the company's financial position, despite continued failure, did not amount to oppression. The issue of shares to directors was not oppressive because the shares were issued to discharge directors' outstanding fees which the company did not have the financial capacity to pay.

REGULATORY MATTERS

ROYAL COMMISSION

The Final Report of the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry was handed to the Federal Government on 1 February 2019 and released on 4 February 2019. The Final Report is 496 pages long and makes 76 recommendations, mostly directed at specific sales and remuneration practices in the banking, superannuation and insurance sectors. The Final Report covers a number of topics that will be of considerable interest to corporate lawyers, with a discussion of "culture, governance and remuneration" issues in Chapter 6, and recommendations relating to the role of ASIC and APRA in Chapter 7.

The overarching theme of the Report's discussion on corporate governance was one of accountability, with the Commissioner stating (at p 394) that "notions of accountability lie at the heart of governance". The evidence before the Commission showed that often, "it was unclear who within a financial services entity was accountable for what. Without clear lines of accountability, consequences were not applied, and outstanding issues were left unresolved" (p 395). The Report rightly recognised the important role that boards have in holding management to account. This is also a theme that has been taken up by ASIC with its corporate governance task force initiative in 2019 (see below).

There is a fine line that needs to be drawn here on what boards can and should be doing. In small, closely held companies it is common for the directors, shareholders and managers to be one and the same, but in large public companies the role of the board must be different. Boards of large companies can't manage the everyday business of the company and by necessity must rely on managers to manage the business. The role of the board is to monitor management and to assist with the company's strategic business operations. Unfortunately, as legal liabilities are increasingly heaped onto directors for seemingly everything that goes wrong within a company, directors attention becomes more focused on compliance frameworks.

The Commissioner was not suggesting that boards need to become more closely involved in management decisions, stating (at p 400): "The task of the board is overall superintendence of the company, not its day-to-day management. But an integral part of that task is being able and willing to challenge management on key issues, and doing that whenever necessary." Many case studies during the Commission showed a failure of boards of financial services companies both large and small to hold management to account for significant and often continuing breaches of the law. We can look to examples of the debacle that has played out with CBA and Westpac in their attempts to respond to large numbers of contraventions of AML/CTF laws. The system for recognising and then responding to these risks must improve, and several senior heads have already rolled in response to the problems being publicised.

Both the Royal Commission and ASIC's corporate governance task force report in 2019 have revealed boards of large public companies that are drowning in information. The Royal Commission final report stated that:

> The evidence before the Commission showed that too often, boards did not get the right information about emerging non-financial risks; did not do enough to seek further or better information where what they had was clearly deficient; and did not do enough with the information they had to oversee and challenge management's approach to these risks. (p 395)

The Commissioner stated that it was not a matter of boards needing *more* information, but rather that they actively ensure that they have the *right* information (see p 400). This requires that boards work with their company secretaries and chairs to ensure an appropriate information flow up to the board. The Royal Commission Final Report reinforces the comments in *ASIC v Healey* (2011) 196 FCR 291; [2011] FCA 717 by reminding boards that it is up to them to determine what information is needed. It is not acceptable to passively receive information that management chooses to provide each month. Boards must hold management to account, and this will require that they are getting the necessary information to do so.

The concept of shareholder primacy and the duties of directors was an important theme throughout the Royal Commission hearings. The Final Report noted that many of the entities considered before the Commission were systematically important to the national economy and therefore the boards and management should be focused on the long-term success and sustainability of the company not merely on short-term profits for shareholders. It is the corporation that should be focus of the directors when satisfying their duties, "and that demands consideration of more than the financial returns that will be available to shareholders in any particular period. Financial returns to shareholders (or 'value' to shareholders) will always be an important consideration but it is not the only matter to be considered" (p 402). The Commissioner also rejected the notion that the interests of shareholders and customers should be seen as somehow opposed, by noting that while some shareholders may take a particular view that short-term profits should be prioritised over other goals, the preferable view was to adopt a longer period of reference which would be likely to see convergence between the interests of shareholders, customers, employees and all associated with any corporation (p 403).

Importantly, the Royal Commission final report reaffirmed support for the "twin peaks" model of regulation where ASIC and APRA share responsibilities. Indeed the report recommended extending ASIC's role in enforcing certain aspects of the BEAR regime, and possibly extending that regime. The Final Report recommends that ASIC be given further responsibilities to approve and enforce all codes of conduct for APRA-regulated entities. ASIC would take on primary responsibility for conduct-related matters under the BEAR while APRA would maintain its focus on prudential regulation. The Report also recommended regular capability reviews be undertaken for ASIC and APRA and that a new regulatory oversight body be introduced to supervise ASIC and APRA.

The Final Report was particularly critical of ASIC's enforcement approach, with few cases against major banks (although since the start of the year that has certainly changed) and recommending that the use of enforceable undertakings be changed so that greater consideration is given to whether they will act as an adequate deterrent and also whether admissions of liability should be included more often. Significantly, the Final Report suggests that infringement notices only be used for administrative failings and not for substantive contraventions of the law. It should be noted that infringement notices have been growing in popularity among state and federal regulators in recent times.

Of particular importance was the Final Report's recommendations to simplify the law by reducing the number of exceptions and modifications that exist within the corporations legislation. Of course, ASIC has the power to make exemptions and modifications through specific provisions in the *Corporations Act 2001* (Cth) and has made thousands of class orders under those powers. Furthermore, the Commissioner recommended (Rec 7.4) that "As far as possible, legislation governing financial services entities should identify expressly what fundamental norms of behaviour are being pursued when particular and detailed rules are made about a particular subject matter."

ASIC seems to have taken up this recommendation by focusing its public statements on its enforcement approach around broad concepts of fairness. It will be interesting to see whether ASIC will provide clearer guidance and whether there is any parliamentary appetite to undertake a broad simplification of the law, Ch 7 being the prime target.

Simplification and clarification initiatives may well provide some tangible benefit in guiding the courts in the application of the law, but a better way to address these recommendations would be to stop adding to the legislation to plug gaps and undertake a fundamental re-evaluation of the Corporations Act. Many other jurisdictions have undertaken wholesale reviews of corporate law in recent years. While such a task would be a significant undertaking and would likely take several years, it would pay long-term benefits to ensure that our system of corporate law provides the right framework for business and for community expectations.

ASIC

ASIC has certainly been in the spotlight during 2019. As noted above, it received extensive criticism both during the Royal Commission hearings and in the interim and final reports. Much of the criticism involved a seeming failure to undertake court proceedings against large financial institutions, with the use of enforceable undertakings and negotiated settlements of regulatory actions scoring particular criticism in the Report and in the media. The Royal Commission report hinted at the need for a separate federal enforcement team if ASIC could not address concerns about the approach it has taken in enforcement and compliance. ASIC responded by setting up an Office of Enforcement and accelerating enforcement activities during 2019. This has been helped by increases in funding and the dramatic increase in penalties and sanctions available under corporations legislation. A key focus of ASIC's new approach builds on the Royal Commission report: "why not litigate". ASIC has been at pains to stress that this does not mean litigate first or litigate everything. Clearly, we can expect more enforcement activity and more court cases both civil and criminal in the next few years as the fallout from the misconduct revealed at the Royal Commission is processed by ASIC and the Director of Public Prosecutions. ASIC is also highlighting the use of technology for its surveillance and other regulatory activities as a key priority in its 2019-2023 corporate plan (released in August 2019).

One of ASIC's highlight activities in 2019 was its investigation of board oversight of non-financial risks, which included placing psychologists in the boardrooms of several large financial companies, reviewing documents and conducting interviews. The report was released in October 2019 and provides some useful insights, such as participation by directors in board sub-committees and the use of metrics to identify and track the management of non-financial risks. ASIC has since announced that it will not continue its shrinks in the boardroom program. ASIC has also implemented a close and continuous monitoring (CCM) program, which places ASIC staff inside large financial institutions. At the time of writing (December 2019) a report on the CCM was due to be released.

ASIC has been busy taking up its new product intervention powers that were passed by the parliament in 2019, and has conducted several public consultations on using the powers for certain derivatives and for certain add on financial products offered by motor vehicle dealerships. ASIC also released several reports concerned with different aspects of consumer insurance products, including unsolicited telephone sales, car insurance claims, consumer credit insurance and total and permanent disability insurance.

ASX CORPORATE GOVERNANCE COUNCIL PRINCIPLES AND RECOMMENDATIONS, 4TH ED

The ASX Corporate Governance Council released the long-awaited fourth edition of its Corporate Governance Principles and Recommendations in February 2019. The fourth edition makes a large number of changes to the third edition and it is beyond the scope of this Annual Review to cover all of them. However, some significant developments include seven new recommendations, amending or rewriting several Principles and substantially rewriting the commentary. The commentary for Principle 1 is amended to provide a greater focus on corporate values and disclosing a board charter and more detailed discussion of the roles of and relationships between the board and management and developing and disclosing a diversity policy and diversity targets. Revisions to the commentary for Principle 2 focus on the definition of independence and how directors are trained (including a new recommendation on directors from a non-English speaking background). Principle 3 has been substantially rewritten, and thankfully the proposed inclusion of material on the entity's social licence (which appeared in the 2018 draft) was dropped in the final version in favour of focusing on the formulation and disclosure of the entity's culture and values, including developing and then disclosing a code of conduct for directors. A new Recommendation 3.3 covers the development and disclosure of a whistleblowing policy. Recommendation 4 now recommends that entities have and disclose their process for verifying the integrity of their reporting. Revisions to the recommendations supporting Principle 5 now give greater focus on ensuring that directors have copies of announcements and also that new investor or analyst presentations should be sent to the ASX ahead of the presentation. A new Recommendation 6.4 states that substantive resolutions should be decided on by a poll rather than by a show of hands. Further guidance on the role and responsibilities of risk management committees is also given in the commentary to Principle 7.

CONCLUSION

My concluding Christmas wish in the 2018 Annual Review was for a broad response to the Royal Commission and to start wholesale corporate law reform. I wasn't surprised that this did not eventuate. Australia seems to have lost the will for broad-based law reform, particularly in corporate law. The demise of CAMAC still casts a shadow over law reform in this area and nothing really has replaced it. While Treasury does a good job with the resources it has, particularly in formal and informal consultation, their resources are both stretched and tied to government policy priorities. At the time of writing Treasury was focused primarily on implementing Royal Commission reforms, which will no doubt see a busy parliamentary program next year. Knee-jerk reactions and regulatory overreach are bound to follow. The public want more enforcement and are fuelled by media calls for more heads on sticks. I expect the focus over the next 12 months to be more ASIC litigation, more APRA litigation and more tough talk about cracking down on the bad apples and recalcitrant sectors of the business community.

While the misconduct revealed in the Royal Commission demands action, we must remember that the focus of the Commission was on admitted misconduct. Many have noted that if we were to hold a Royal Commission into misconduct in almost any area of the economy, we may not like what is revealed. It's not hard to find conduct falling below community expectations (whatever that might mean in a particular case) when you have the coercive powers of a Royal Commission. The more important question is what we should do about it?

Few would disagree with the Royal Commission's exhortation that penalties for legal non-compliance (ie breaking the law) must not simply be treated as a cost of doing business. The new penalties introduced in 2019 into both civil penalty and criminal penalty regimes in the Act will provide ASIC with sufficiently large sticks to discourage misconduct. New powers on disgorgement, and criminal sanctions of up to 10% of annual turnover are enough big enough to be material for even Australia's largest corporations. The difficulty will be in ASIC maintaining a delicate balance between different sanctions in the regulatory pyramid. "Why not litigate" could end in a morass of complex and expensive litigation that benefits no one (including the lawyers involved as the work safety issues thrown up during the Royal Commission hearings demonstrates). Businesses need appropriate guidance, not just more court rulings which are by necessity limited to their factual foundations. More mega-litigation involving dozens or even hundreds of allegations founded on complex legal arguments are unlikely to provide the necessary guidance for businesses to do the right thing in the first place.

Commissioner Hayne's call for simplification of corporate law should be the guiding focus for future initiatives. If all 2020 brings is more legislation to address problems raised by the Royal Commission, then we will have missed an opportunity to drive constructive change to help improve business and support the economy. Fighting the last war and constantly reacting to public scandals has unfortunately been a feature of corporate law reform since the 1950s. We need to take back the law reform vision last seen during the CLERP program in the 1990s. A wholesale review of the *Corporations Act 2001* (Cth) is well overdue and should be a priority of the Australian Law Reform Commission. While hope springs eternal, I won't be holding my breath for this to happen.