



Insight

Corporate & Commercial

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In This Edition:

- Personal Property Securities reform in Australia
- Unconscionably harsh termination clauses are void as a penalty
- Liability for misleading and deceptive promotional activities of a subsidiary
- The One-Tel case and developments in Directors and Officers' duties
- In brief

Personal Property Securities reform in Australia

Personal property securities law in Australia has undergone significant scrutiny in recent months, resulting in a complex and rigorous overhaul of the current regime to facilitate the establishment of a single national system for secured lending over personal property.

On 14 December 2009, the Personal Property Securities Bill 2009 (**PPS Act 2009**) and the Personal Property Securities (Consequential Amendments) Bill 2009 (**Consequential PPS Act**) received Royal Assent.

The PPS Act 2009 and Consequential PPS Act will apply after the registration commencement time, expected to be in May 2011.

What will the regime do?

The PPS Act 2009 seeks to establish:

- rules for the creation of valid security interests in personal property;
- rules governing the priority of competing security interests;
- an enforcement regime to supplement any contractual arrangements between parties; and
- a register that will provide notice of any security interests in personal property.

As such, the regime will be relevant to and will impact upon all Australian businesses.

What does the reform entail?

The legislative reform is to apply to all personal property security interests. It looks to remove uncertainty arising from the current range of Commonwealth, State and Territory legislation, as well as common law and equitable legal principles that apply to personal property security interests.

A key aim of the Act is to introduce a new regime that provides greater certainty in respect of the rights of parties to enforce their interests in personal property. The essential concern is the issue of priority where there are competing interests.

Amongst other changes, a new PPS Register will replace the existing register of company charges maintained by the Australian Securities and Investments Commission (**ASIC**), and repeal or amend Chapter 2K of the Corporations Act, which sets out the procedure for registering charges over the property of a company with ASIC, as well as the rules for determining the priority of charges. The core functions of the PPS Register are expected to be established by May 2010.

What is personal property?

The Act contemplates that personal property will be defined as any form of property that is not land or buildings, and as such includes tangible property such as motor vehicles, machinery, office furniture and stock-in-trade and intangibles such as intellectual property rights.

How is a personal property security created?

The Act provides that a security in personal property is created when a financier takes a legal interest in personal property as security, or alternatively, enters into a transaction that involves the provision of secured finance.

Personal Property Securities (Corporations Amendment Bill) 2009

The draft Personal Property Securities Bill (Corporations and other Amendments Bill) 2009 – Amendments to the Corporations Act 2001 (**PPSB Corporations Amendment Bill**) seeks to make appropriate amendments to the Corporations Act to reflect the new personal property securities regime. As such it proposes the following key changes:



Insight - Corporate & Commercial

March 2010

- the repeal of Chapter 2K (registered charges) of the Corporations Act;
- the introduction of "Retention of Title Property" within the definition of property in the Corporations Act; and
- the preservation of existing rights to ensure amendments do not interfere with the current Corporations Act.

The PPSB Corporations Amendment Bill is currently before the Standing Committee of Attorney-Generals for consultation.

Implications to consider

The provisions of the new legislation will radically change the law in relation to personal property securities. Although the registration time is not expected until May 2011, companies are

expected to start preparing now.

Companies should examine the standard terms under which property is acquired and disposed. In most cases, these will be defined as security interests and your rights and priorities may be affected.

Any existing security interests and charges must be registered with the new PPS Register within 24 months of the commencement date. Transitional provisions will cover a 24 month transition period until May 2013. Any outstanding security interests and charges must be registered by then or risk losing priority.

Unconscionably harsh termination clauses are void as a penalty

In *Zachariadis v Allforks Australia Pty Ltd* [2009] VSCA 258 the Victorian Court of Appeal upheld an appeal from a decision of the County Court and held that a liquidated damages clause in breach of contract was not a genuine pre-estimate of damages and was subsequently void as a penalty.

Facts

In 2006 Zachariadis, as director of Priority Road Express Pty Ltd (**PRE**), entered into four agreements with Allforks Australia Pty Ltd (**Allforks**) for the hire of forklifts that contained guarantees. The termination clauses of the agreements stipulated that PRE would be required to pay all charges which would have been payable from the date of termination to the expiry date of the agreements if the agreements were terminated within the hire period.

After a period of four months, PRE went into receivership and consequently breached the hire agreements by failing to pay charges owing. The agreements were terminated and Allforks sought liquidated damages for outstanding charges as well as charges that would have been payable from the date of termination to the expiry date, as per the termination clause.

At first instance, judgment was found in favour of Allforks. It was held that clauses requiring payment for the unexpired term of the relevant hire agreement did not impose a penalty.

Decision

The Court of Appeal subsequently found in favour of the appellant, Zachariadis. In considering whether the termination clause was a penalty or provision for payment, it was held that a sum fixed by a contract is a penalty only if it is 'extravagant and unconscionable' in comparison with the greatest loss that could conceivably be proved to have followed from the breach.

The applicable test was the "out of all proportions" test applied in *Amev-UDC Finance Ltd v Austin* (1986) 162 CLR 170, where it was held that if there was a significant disproportion between the sum agreed to be paid and a genuine pre-estimate of damages, then the sum should be held to be a penalty.

The Court of Appeal outlined the relevant termination clause void as a penalty because:

- it did not provide a means of calculating the net loss Allforks would suffer if the hire agreement was terminated early;
- there would have been no difficulties in establishing the quantum of any genuine pre-estimate loss suffered as a result of the breach if the parties had drafted a clause providing a formula for a pre-estimation of loss likely to be suffered; and
- the requirement to pay all future charges under the agreement applied in the event of 'any breach' which gave right to termination. The lack of any relationship between the breach and the amount payable under the clause indicates that the clause was not a genuine pre-estimate of loss.

Implications

The decision provides a reminder to parties negotiating a contract that difficulties can arise in establishing the quantum of any loss suffered if there is no means of calculating the loss in the event of a breach. Parties should be aware that a liquidated damages clause may be construed as a penalty if it is not drafted with a genuine pre-estimate of the loss likely to be suffered in the event of a termination or breach, no matter how trivial the termination or breach. If a Court determines the clause to be a penalty, then it will be void.



Insight - Corporate & Commercial

March 2010

Liability for misleading and deceptive promotional activities of a subsidiary

Background

In 1999, Austcorp International Ltd (**Austcorp**) became involved in the development of a waterfront resort on the Central Coast of New South Wales. The marketing and management of the development was contracted to Austcorp Development Management Pty Ltd (**ADM**), a subsidiary of Austcorp.

During the course of the marketing and promotion of the apartments in the resort, certain representations were made to prospective purchasers regarding a 7% guaranteed net return and the identity of the proposed operator of the resort. Such representations were subsequently held to be misleading and deceptive and it was held that small print in the contracts of sale did not correct or displace the earlier misleading representations.

Less than 2 years after the purchase price was paid, the resort performed poorly and the applicants commenced proceedings against Austcorp alleging that it had engaged in conduct that was misleading or deceptive in breach of section 52 of the *Trade Practices Act 1974* (Cth).

Austcorp maintained that any misleading and deceptive conduct should be brought against ADM as the development and management agreement made it clear that ADM was responsible for the marketing and promotion of the apartments.

Decision

It was held that Austcorp made misleading representations notwithstanding that it had no direct contractual involvement with the applicants. The Court was of the view that Austcorp conducted itself in trade and commerce as the promoter of the resort for a number of reasons, and noted the following:

- during the construction of the resort, the word “Austcorp” was used together with the Austcorp logo on a large sign on the construction site;

- promotional brochures featured the Austcorp logo (without identifying a particular Austcorp company);
- Austcorp’s name and logo appeared in letters to purchasers of the apartments in connection with the resort project; and
- suppliers to the development of the resort addressed invoices to Austcorp rather than ADM, which Austcorp subsequently paid (although bookkeeping entries were internally allocated to ADM).

The decision also highlighted the significance of the Austcorp logo on the brochures and leaflets where the conduct of Austcorp created a situation in which people would associate it in trade or commerce as the promoter of the resort. However, the message which Austcorp wished to pass to the public was that it, as the ultimate owner of the brand, was responsible for the development.

The court rejected Austcorp’s argument that the corporate veil should shield their responsibility from the conduct of ADM as Austcorp was the hands and brains of its subsidiaries’ conduct and cannot evade responsibility for any contravention of section 52 by seeking to rely on the corporate veil.

Implications

A parent company’s direct or indirect involvement in a business project of their subsidiary can potentially expose the former to liabilities under the *Trade Practices Act*, notwithstanding the contractual arrangements in place to protect against liability. When making representations to potential clients it is beneficial that the representations made are accurately reflected in formal contract documents in order to negate potential false and misleading claims.

It should be noted that Austcorp has been granted leave to appeal to the Full Federal Court.



Insight - Corporate & Commercial

March 2010

The One.Tel case and developments in Directors and Officers' duties

The recent One.Tel case (*ASIC v Rich* [2009] NSWSC 1229), where ASIC's allegations against two former directors of One.Tel, Mark Silbermann and Jodee Rich, were rejected by the New South Wales Supreme Court in a 3,000 plus page judgment, has been the subject of intense media interest. The decision by Justice Austin has many significant implications for company directors and officers. It focuses attention on the nature of the duties that managing directors and finance directors owe to companies and the extent to which they are obliged to pass on financial information to company boards. Criticism of ASIC's handling of the case is also likely to affect the way the regulator approaches future prosecutions of alleged breaches of duties of directors and officers.

ASIC's claim

ASIC claimed that Messrs Rich and Silbermann had breached their duties as directors and officers by failing to make proper disclosure to the One.Tel board of the poor financial position of the One.Tel group prior to its collapse in May 2001.

In particular, ASIC focused on the reported financial position of the group in each of the months of January, February, March, April and May of 2001 as opposed to the actual position, and the basis on which Messrs Rich and Silbermann made forecasts and reported financial information to the board.

Evidentiary Issues

Because the ASIC claims covered alleged continuous breaches of duty over such a lengthy period of time, a considerable body of evidence and conduct needed to be examined by the Court in One.Tel in order to ascertain whether there was any breach of duties by Rich and Silbermann. Ultimately, Justice Austin found that the evidence presented to him (while extensive) was in many cases insufficient to support ASIC's case. By contrast, in the James Hardie decision (where ASIC was successful), the main evidentiary issue surrounded the release of a press announcement to the market. In light of this, it is widely expected that ASIC will adopt a narrower approach in framing prosecutions for breaches of directors and officers duties in subsequent cases.

The legal issue – breach of duty

Section 180 of the Corporations Act provides that directors and officers have a basic duty to exercise their powers and discharge their duties with the care and diligence that a reasonable person would exercise, taking into account the

corporation's circumstances, the offices occupied by the person and their responsibilities within the corporation.

There is a statutory defence to an allegation of breach of section 180. This is contained in section 180(2) and is referred to as the "business judgment rule." This rule provides that a director or officer will have been taken to have discharged their obligations in accordance with section 180 if he or she:

- makes a 'business judgment' in good faith and for a proper purpose;
- does not have a material personal interest in the subject matter the judgment;
- informs himself or herself about the subject matter of the judgment to the extent he or she reasonably believes to be appropriate; and
- rationally believes that the judgment is in the best interests of the corporation.

The One.Tel case concerns itself with the duty of care and diligence of a joint CEO (Jodee Rich) and finance director (Mark Silbermann) respectively. Justice Austin refers significantly to previous case law and, in particular, his own decisions in a number of cases in relation to the similar content matter. In considering the nature of the duty of care, one key question is the extent to which the standard of conduct expected of a director and officer is objective or subjective and, in particular, how a Court will have regard to the circumstances of the relevant corporation and the responsibilities of that particular director or officer.

The One.Tel decision considers the distinction between the application of section 180 to non-executive and executive directors. For example, a non-executive director is not involved in day to day management of the company and is entitled to some extent to rely on information provided by the executives and management. However, non-executives should keep informed about and monitor a company's affairs and activities and need to have a good understanding and grasp of the financial position of a company so they can form an opinion as to the company's solvency. It was noted that both a managing director and finance director need to have a detailed understanding of financial reporting and cash flow issues so that they can appropriately monitor a company's performance and ensure the company complies with its obligations under the Corporations Act (and the ASX Listing Rules if applicable). This was at the heart of the decision.



Insight - Corporate & Commercial

March 2010

There is also some further guidance in the *One.Tel* case about the operation of the business judgment rule and the circumstances in which it may apply. For example, it may be applicable to decisions that directors and officers make about planning, budgeting and forecasting but not to duties to monitor a company's affairs or financial position.

Conclusion

While the judgment criticises the broad nature of ASIC's case and the evidence adduced, it is clear from the decision that the standard of care and diligence expected of directors and officers is objective but that a Court will take into account the corporation's circumstances, the offices occupied by the relevant person and their responsibilities within the corporation.

Any executive director will be required to have a detailed understanding of their company's financial performance and position. Although ASIC were ultimately unsuccessful in the *One.Tel* case, executive directors will need to consider carefully the systems in place for giving financial information about their company to non-executive directors and assess whether or not they are adequate.

Although ASIC had originally indicated its intention to appeal this decision, ASIC has recently announced that it will not appeal the decision. In any event, however, 2010 will be a significant year

for Australian directors duties law as a number of other recent directors' duties cases are also subject to appeals (including the James Hardie case (*ASIC v MacDonald*), the AWB case (involving Mr Lindberg, former CEO of AWB) and the Fortescue Metals decision).

So where does that leave directors and officers in terms of understanding their risk and liability?

- The Courts have recognised that directors and officers need to be entrepreneurial when making decisions that are in the best interests of a company and this involves risk.
- How directors and officers are perceived to have accounted for, measured and responded to risk, will determine whether they will have discharged their duty of care and diligence. In this context, it is recommended that executive directors and chairmen review carefully their existing processes regarding the provision of financial information to other board members.
- To the extent that the law allows directors to obtain expert opinions and rely on input of other parties, this will assist in showing their duties have been discharged.



Insight - Corporate & Commercial

March 2010

In Brief

New executive termination payments laws

In late 2009, the Corporations Amendment (Improving Accountability on Termination Payments) Act 2009 (Cth) was passed. That legislation has introduced amendments to the Corporations Act which:

- expand the range of company personnel whose employment termination benefits will now potentially require shareholder approval;
- reduce the threshold for shareholder approval of termination benefits for employment contracts that are entered, renewed, extended or have their conditions varied after the commencement of the legislation to an amount of 1 year's average base salary; and
- restrict associates of the retiree from participating in the shareholder vote on the termination payment.

Employee share schemes tax legislation passed

The Tax Laws Amendment (2009 Budget Measures No. 2) Act 2009 (Cth) received assent on 14 December 2009 but the measures in the legislation take effect from 1 July 2009. As foreshadowed in the 2009 Budget, the Act provides that the \$1,000 upfront tax exemption available to employees participating in qualifying employee share schemes is now subject to a means test and will only be available to taxpayers with an adjusted taxable income of less than \$180,000 (in line with the top marginal tax bracket). In addition, although the Act continues to enable employees to potentially defer paying tax on discounts on shares, rights and stapled securities acquired under an employee share scheme, this will only be the case if there is a 'real risk' the taxpayer might forfeit the share, right or stapled security acquired under the scheme. It is appropriate for companies and employees to review employee share scheme arrangements to ascertain how they may be affected by the legislation.

Reform of legislation imposing liability on directors and officers

As part of the ongoing process of reforming the many statutes imposing personal liability on directors and officers of companies, the Ministerial Council for Corporations (**MINCO**) published a set of principles relating to personal liability for corporate misconduct. These principles have been developed with the intention of implementing a consistent approach to this issue across Australian law.

The next steps in the reform process are as follows:

- A legislative review is to be conducted by each jurisdiction to identify those existing offences for which directors' liability, or removal of that liability, is appropriate in accordance with the MINCO principles.
- Laws are to be harmonised following cross-jurisdictional comparison in key policy areas. A consistent legislative approach is to be adopted to provisions imposing director and officer liability around key concepts and definitions.

ASIC seeks comment on information leaks

In December 2009, ASIC released a consultation paper and a draft regulatory guide (**Guide**) the issuing of which would implement "Best Practice Guidelines" for dealing with confidential information primarily in the context of capital raisings and mergers and acquisitions.

The issue by ASIC of this consultation paper occurs in the context of ASIC taking on a greater role in market regulation and follows the suspicious increases in trading, noted by ASIC, immediately prior to a number of capital raisings and merger and acquisition transactions in 2009 which ASIC allege resulted from leaked confidential information.

The Guide suggests the implementation of a number of procedures and policies which aim to protect the confidentiality of sensitive material and identify those responsible in the case of breach. These include requiring companies to keep lists of all persons (including persons working within a company's external advisors) with access to that company's confidential information for a particular transaction and the recommendation that in some circumstances confidentiality agreements should be entered into with each of these persons. In cases where there is a leak or a suspicion of a leak, ASIC recommends that the company should consider conducting a formal investigation.

The consultation paper and the Guide also suggest that the carrying out of market soundings by investment banks may be an area where confidential information is being inappropriately or inadvertently disclosed and puts in place guidelines to govern the conduct of market soundings. These guidelines recommend the use of formal scripts and require that entities that are sounded must agree, before any confidential information is disclosed, to keep that information confidential.

ASIC have indicated that the purpose of the Guide is to "encourage companies, their advisors and other service providers to implement and enforce best practice guidelines not just a minimum level of compliance with the law." Given that the regulatory guide (if implemented) will not have legislative force it will be interesting to note the view taken by those affected on whether to implement these recommendations.

The consultation paper states that the final regulatory guide is to be released in April.

Insight - Corporate & Commercial

March 2010

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