

NEWSLETTER

DECEMBER 2014

Corporate & Commercial Newsletter

Welcome to our December Corporate & Commercial newsletter

In this edition we have included news on:

- a recent decision in which receivers sought directions from the court on dealing with goods and other matters (*Re Arcabi*)
- the new China-Australia Free Trade Agreement (**ChAFTA**)
- *THC Holdings Pty Ltd v CMA Recycling Pty Ltd*, which considered when administrators are liable for the sale of goods
- the regulation of crowd sourced equity funding (**CSEF**) and recommendations for a specific regulatory regime designed to facilitate the growth of CSEF
- *Howard v Commissioner of Taxation* and directors' fiduciary duties (the taxation context).

Please do not hesitate to contact us if you would like more information on any topic, whether covered in this newsletter or not. We hope you find the newsletter informative and useful.

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Recent PPSA case: directions sought by administrators on goods held by corporations

Background

In *Re Arcabi*,¹ the receivers sought directions from the court on dealing with goods and other matters. In particular, the receivers sought confirmation that they were justified in returning goods that were stored on the company's premises (**mixed storage goods**) to third parties, and returning goods that the company had agreed to sell on consignment (**consignment only goods**) to third parties.

¹ *Re Arcabi Pty Ltd (Receivers & Managers Appointed) (In Liq); Ex parte Theobald & Herbert in their capacities as receivers and managers of Arcabi Pty Ltd (Receivers and Managers Appointed) (In Liq)* [2014] WASC 310



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Decision

Master Sanderson of the Supreme Court of Western Australia found that the *Personal Property Securities Act 2009* (**PPSA**) did not apply to both the mixed storage goods and the consignment only goods. Regarding the mixed storage goods, the court found that the arrangement was akin to a bailment and did not create a security interest under the PPSA. Regarding the consignment only goods, the court found that no security interest vested in Arcabi pursuant to section 267 of the PPSA.

The Supreme Court held that the receivers were entitled to be indemnified for their work in identifying and returning stock that was at Arcabi premises, and in caring for and preserving the value of those goods. Therefore, the receivers could assert a lien to secure such indemnity. The court also found that the receivers were entitled to an indemnity from third parties who benefited from the insurance of their goods.

Comment

This decision shows the complexity of applying the PPSA in practice, and clarifies PPSA provisions regarding bailments and commercial consignments. It also confirms the position on receivers' rights of indemnity and liens regarding costs and expenses incurred in identifying and preserving goods owned by third parties.

Author: **Vanessa Gandel**

Contact: **Ian Sinclair**, Partner

China-Australia Free Trade Agreement (ChAFTA)

The China-Australia Free Trade Agreement (**ChAFTA**) will provide substantial new benefits to Australians. Notably the agreement will give Australian businesses access to the world's second largest economy. ChAFTA will reduce and remove tariffs, and will create greater flexibility for Australia and China investments. The key areas in Australia that are set to benefit from ChAFTA include agriculture, resources and energy, manufacturing exports, financial services and investment.

Agriculture

ChAFTA provides for a reduction in or removal of tariffs for certain Australian export goods. For example, the agreement sanctions the removal of all tariffs on Australian dairy products. While most of these changes are set to take place a few years after ChAFTA's approval, some of the tariff cuts are going to take effect from day one – such as the removal of the tariff on barley.

Energy, resources and manufactured goods

Energy, resources and manufacturing goods in Australia will benefit from ChAFTA, particularly with the reduction of tariffs on China's import of these products from Australia. As part of ChAFTA, most of the tariffs on energy, resources and manufactured products will be removed, with the aim that upon full implementation of the agreement, 99.9% of Australia's current resources, energy and manufacturing exports will be tariff free.

Investment

ChAFTA will improve investment opportunities for investors in both China and Australia. ChAFTA will promote further growth of Chinese investment into Australia by increasing the Foreign Investment Review Board screening threshold at which investments by private companies from China in non-sensitive sectors are considered from \$248 million to \$1,078 million. ChAFTA will include an Investor State Dispute Settlement (**ISDS**) mechanism, with the aim of enabling Australians to invest in China with greater confidence. Under ChAFTA, the Australian government will still screen all investments by Chinese State-Owned Enterprises and will be able to screen investment proposals by private investors from China in agricultural land valued from \$15 million and agribusiness from \$53 million.

Services

Financial services

ChAFTA will have a remarkable impact on the financial services sector in Australia. In particular, with the establishment of an official Renminbi clearing bank in Sydney, Australian financial



institutions will be able to invest Chinese currency in Chinese financial products. The clearing bank will provide a direct means of facilitating cross border Renminbi transactions and will improve the efficiency of Renminbi transactions between Australian and Chinese entities.

Legal services

Upon the implementation of ChAFTA, Australian law firms will be able to establish commercial associations with Chinese law firms in the Shanghai Free Trade Zone. This will eliminate many of the current restrictions and limitations associated with cross-border transactions.

Education, tourism and healthcare services

The education sector will enjoy substantial growth opportunity as a result of ChAFTA. Under the agreement 77, institutions will be added to the existing 105 Australian institutions that can accept Chinese students. Tourism services will also benefit because China has guaranteed that Australian service suppliers will be able to construct, renovate and operate hotels and restaurants. Travel agencies will be able to establish wholly Australian owned subsidiaries in China for tours within China. Further, there appears to have been a dramatic increase in demand for healthcare in China. As a result, ChAFTA has allowed wholly Australian owned hospitals and aged care institutions to be established in China.

Comment

ChAFTA will provide substantial benefits to Australians, and in particular will give Australian businesses access to the world's second largest economy. This will allow many businesses to expand and increase profits. The flow-on benefits of ChAFTA

remain to be seen.

Author: **Vanessa Gandel**

Contact: **Ian Sinclair**, Partner

Administrators liable for sale of goods – complying with s 442C Corporations Act 2001

Background

In the recent NSW Supreme Court case *THC Holdings Pty Ltd v CMA Recycling Pty Ltd* [2014] NSWSC 1136, CMA entered into a contract to supply 5,800 metric tonnes (**MT**) of scrap metal to THC for shipment. CMA was unable to source 1,367MT prior to shipment (**shortfall**). THC sourced the shortfall from a third party. It was agreed that CMA would supply the shortfall to THC at a later date.

On 22 July 2013 CMA accumulated the shortfall (**shortfall stock**) in a separate area to its other stock. THC paid for the shortfall stock on 29 July 2013 and administrators were appointed to CMA on 2 August 2013. THC notified the administrators that they were the owners of the shortfall stock. On 19 September THC applied *ex parte* for an injunction restraining the sale of the shortfall stock, unaware that it had in fact been sold by the administrators eight days earlier.

Decision

The court determined that THC became the owner of the goods on 22 July 2014 once the shortfall stock was accumulated, finding that the administrators had breached section 442C of the *Corporations Act 2001* (**Act**) by selling the shortfall stock without meeting the conditions for disposal in s 442C(2).

Further, Stevenson J found that the sale of the shortfall stock as part of the sale of the entirety of CMA's assets was not in the 'ordinary course of CMA's business'. Further, the administrators neither sought THC's consent to the sale nor leave of the court to dispose of the shortfall stock as required by s 442C of the Act.

The court decided that CMA was a 'bailee for reward' of the shortfall stock and therefore owed THC a fiduciary duty not to act in a manner that preferred its interests over those of THC. Stevenson J held the administrators liable to account in equity on the basis that the administrators participated in and procured CMA's breach of fiduciary duty.

Even though s 442C does not set out the consequences for breaching the Act, the court considered the administrators were liable for damages pursuant to s 1324(10). Stevenson J noted that a claim for damages under the latter section was not available where there is no prospect of an injunction being granted because, on the facts, the shortfall stock was sold prior to the application for injunctive relief. However, he interpreted the section broadly and considered that damages could be a 'substitute remedy, or supplementary remedy for an injunction' and thereby awarded damages in favour of THC.

The court is yet to make final orders; hence it is unclear whether the administrators will be indemnified out of the company's property for the amounts for which they are liable in accordance with ss 443D and 443E of the Act.



Impact

This case emphasises the care administrators must take when identifying and disposing of property, particularly where property is not owned by the company under administration or is the subject of a security interest in accordance with section 442C.

Author: **Damien Mainzer**

Contact: **Ian Sinclair**, Partner

Regulation of crowd sourced equity funding in Australia

The Corporations and Markets Advisory Committee (**CAMAC**) has reviewed the regulation of crowd sourced equity funding (**CSEF**) and made recommendations for a specific regulatory regime designed to facilitate the growth of CSEF. In doing so, CAMAC balanced two competing concerns: investors want to be confident

in the process and the company they are buying in to; and issuers are cautious about issuing large numbers of shares and losing control of their projects.

Currently, the *Corporations Act 2001* (**Act**) limits the ability of issuers to fundraise utilising CSEF. Small proprietary company issuers can have no more than 50 non-employee shareholders and must prepare a prospectus for public offers of equity unless they fall into some limited exceptions under the Act.

CAMAC proposes a new scheme that will allow corporate entities (generally start-ups and entrepreneurs) seeking to raise capital (**Issuers**) to promote to investors online. In turn, small investors will be afforded new access to investment opportunities.

Issuers

Under the proposed scheme, two types of companies will be able to use CSEF:

- regular public companies;
- a new class called 'exempt public companies'.

During their start up phase, exempt public companies will not be required to comply with the:

- continuous disclosure requirements under Chapter 6CA of the Act;
- requirement to hold an AGM;
- two strikes rule;
- requirement to prepare a remuneration report;
- requirement to appoint an auditor (but only until the company has raised \$1m and has expended \$500,000).

The 'start up phase' will be deemed to have finished and a company will automatically lose its exemption status upon:

- meeting a threshold of \$5m annual turnover; or
- reaching \$5m capital and remaining there for six months; or
- being an exempt public company for three years; or
- voluntarily deciding to become a public company.

Rather than preparing a company prospectus to cover 'all information reasonably required by investors', eligible companies would need to prepare a disclosure document following a template prescribed by ASIC. The template would likely cover:

- offer size;
- method of pricing the shares and the company's equity structure;
- the length of time that the offer will be open (which is to be no more than three months);
- a generic risk warning about CSEF;
- the potential for investors to be diluted;
- the company's business plan;
- any previous CSEF by the company; and
- the intended use of funds.

This would allow for investors to easily compare different investment opportunities.

Limits on investment

Companies are not precluded from issuing any particular class of shares. The key to compliance will be disclosure. Following



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the prescribed template, the offer document will fully disclose the company's equity structure as well as other relevant matters. Companies will also be allowed to issue different classes of shares to crowds and private investors.

For issuers

- Maximum of \$2m per annum allowed to be raised using this method.
- Other fundraising channels are still available (full prospectus, offers to sophisticated investors, 20/12 small scale offers). Amounts raised by offers to sophisticated investors do not count towards the \$2m total.
- This means that an issuer who has taken advantage of the 20/12 rule and issued shares to more than 20 friends or relatives in a 12 month period and raised more than \$2m, will not be able to conduct CSEF. You cannot raise more than \$2m per annum total using any combination of CSEF and 20/12.

For investors

- Investors are limited to a \$2,500 investment per annum per company. The total annual cap on investments is \$10,000.
- They are also required to sign a risk acknowledgement and have particular cooling off periods.

Intermediaries

An intermediary is an Australian online portal where investors and issuers connect. The offer and acceptance process will be run by the intermediary in no defined format. The intermediary would need to apply for a licence from ASIC (the details of which have not been confirmed by CAMAC).

As well as facilitating the process, the intermediary would likely be required to:

- conduct limited due diligence checks on issuers (but not on an issuer's business or business plan);
- provide a generic risk disclosure statement to CSEF investors;
- check compliance with investor caps in some instances;
- provide communication facilities between issuers and investors;
- disclose the fees they charge.

CAMAC proposes various different options for how the intermediary may collect and hold funds, including holding the funds on trust until a certain amount is reached, passing on this obligation to a third party, or having investors contribute directly to the issuer.

Risk

In the last decade, the internet has created or enhanced the means by which individuals or companies can bring offers to the attention of a vast crowd of potentially interested parties. However, the use of the internet for this kind of activity also carries with it an inherent risk of fraud to all parties. This may be in the form of false websites being established to obtain credit card details or genuine websites being used to promote false projects and obtain funds.

This risk may be mitigated by the relatively low loss likely to be suffered by investors, but is still high for issuers who could fall victim to fraudulent activity.

Comment

CAMAC has provided a detailed and comprehensive review of the current state of CSEF in Australia and the world. It has offered various potential ways that Australia can move forward in improving this type of equity funding locally; these are outlined in greater detail in its full report.

Author: Victoria Moffat

Contact: Ian Sinclair, Partner

Directors' fiduciary duties – the taxation context

Background

In the recent High Court case of *Howard v Commissioner of Taxation* [2014] HCA 21, Mr Stephen Howard was one of six parties in a joint venture where a golf course was to be acquired and then on-sold to a third party. Disctronics Ltd was to be the purchaser of the golf course. Disctronics' opportunity to purchase the golf course was diverted from a third party purchaser and litigation ensued in the Supreme Court of Victoria and the Court of Appeal. The Court of Appeal decided that the joint venture opportunity had been wrongly diverted, ordering equitable compensation in favour of Mr Howard and the other wronged members of the joint venture.

The Commissioner of Taxation assessed the compensation as assessable income, despite Mr Howard directing payment to Disctronics pursuant to a litigation funding agreement.



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The High Court appeal

Mr Howard argued that he breached his fiduciary obligations to Disctronics (of which he was a director) by preventing the company from purchasing the golf course. The issue for consideration in the High Court was whether the award of equitable compensation received by Mr Howard was received in his personal capacity or as a constructive trustee.

The High Court held that Mr Howard did not receive the compensation as a constructive trustee because there was no actual or real possibility of a conflict of interest between the fiduciary duties owed to those in the joint venture and the duties owed by him as a director of Disctronics. Mr Howard acted in accordance with his duties as a director in an attempt to secure the opportunity to invest in the golf course for Disctronics. The opportunity for Disctronics to purchase the

golf course was prevented when the joint venture failed to agree and not by any conduct of Mr Howard.

Where company directors are also shareholders of a company, directors' decisions may affect their personal interests – but they do not breach their fiduciary obligations merely because in promoting the interest of the company, they are also promoting their own interests. However, the High Court made clear that 'a decision taken by directors to advantage themselves other than as members of the general body of shareholders would constitute an abuse of the fiduciary power'.

Impact

Fiduciary duties are not infinitely extensible and the scope of the fiduciary duty must be consistent with and conform to the 'scope and limits of that relationship'.

It is necessary to identify the separate and distinct business and professional relationships that often occur simultaneously and have an understanding of the duties that arise and the obligations that apply.

Author: Damien Mainzer

Contact: Ian Sinclair, Partner

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This newsletter is intended to provide general information on legal issues and should not be relied upon as a substitute for specific legal or other professional advice.

Team Member Profile

Dean Katz, Partner, Corporate & Commercial

Dean's expertise lies in corporate and commercial law, including mergers and acquisitions (**M&A**), drafting and negotiating contracts, and advising on the legal aspects of corporate governance and general corporate matters. His experience in M&A transactional work cuts across a range of industries, including the extractive industry, energy and resources, transport and logistics, manufacturing and retail.

In addition, Dean has a keen focus on laws affecting the extractive industry and associated sectors, representing multinational extractive operators and also independently owned businesses in the acquisition, establishment and development of quarry sites in Victoria. He regularly appears in the Victorian Civil and Administrative Tribunal (**VCAT**) and has vast experience in negotiating/mediating with government authorities regarding work authorities, planning permits, existing use rights and the

commencement/expansion of quarry developments and concrete batching facilities.

Dean has a sound understanding of environmental laws and considerations relating to planning and the extractive industry in Victoria, including the:

- *Planning and Environment Act 1987*
- *Mineral Resources (Sustainable Development) Act 1990*
- *Environment Protection and Biodiversity Conservation Act 1999*
- *Flora and Fauna Guarantee Act 1988*
- *Local Government Act 1989*

In 2013, Dean was selected as a finalist of the Lawyers Weekly 30 Under 30 Awards in the Planning & Environment category (with a focus on his experience within the extractive industry).



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