

# COMMERCIAL LAW JOURNAL

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## Editorial

In this edition there are the regular updates on finance and securities law, corporations law, intellectual property law and taxation law.

In the taxation law update, the new laws relating to Superannuation and the taxation benefits available to taxpayers upon reaching the age of 60 years are discussed in some detail. The fact that the contributions paid to them on retirement are tax free, has dominated the financial news over recent months. The recent initiative by ASIC to review the law relating to buy-backs in listed managed investment schemes is examined in the finance law update. The corporations law update discusses the recent recommendations of the 'Corporations and Market Advisory Committee, CAMAC, in relation to disclosure requirements and infringement notices and sanctions which now form part of the Government's discussion papers on corporate law reform. The intellectual property update discusses confidentiality and whistleblowing.

This edition contains a refereed paper on 'authorising' of copyright infringement by peer-to-peer file sharing software in music downloading. The paper provides a current analysis of the recent cases that have been before Courts in the USA and Australia and the approaches taken by the respective Judges to try to curb the copyright infringement. There is also a case note on the recent 'Sons of Gwalia' case and the High Courts' decision which has important implications for shareholders and other unsecured creditors.

# Corporations Law Update

## Law Reform

Corporate law reform is bubbling away again, with the Federal Government issuing three discussion papers reform in early March 2007.<sup>1</sup>

These followed shortly after the Treasurer's reference of the issues raised in the case of Sons of Gwalia<sup>2</sup> to CAMAC.<sup>3</sup> CAMAC has also not yet<sup>4</sup> issued a discussion paper on this issue and so this issue presumably also remains under review.

### **Discussion Paper: Infringement Notices**

The first discussion paper calls for submissions on the operation of the infringement notice provisions and more broadly, the sanctions generally available under the Corporations Act 2001.<sup>5</sup> The consultation paper is essentially a review of the infringement notice provisions since their introduction almost three years ago.<sup>6</sup> Submissions may be made until 1 June 2007.

The infringement notice provisions were intended to introduce a quick and easy method to encourage disclosing entities<sup>7</sup> to comply with their continuous disclosure obligations. Broadly, these obligations<sup>8</sup> oblige disclosing entities to inform either the market operator (if the entity is listed) or ASIC (if the entity is unlisted) about information that:

- the entity has, that is not generally available; and
- which a reasonable person would expect, if it were generally available, to have a material effect on the price or value of the relevant securities.

These obligations are supplemented for listed entities by the obligations (and exceptions) set out in the applicable listing rules.

Before introduction of the infringement notice provisions, ASIC could only resort to the slow and sometimes cumbersome criminal and civil sanctions available under the Corporations Act.<sup>9</sup>

Nowadays, if ASIC considers that a disclosing entity has breached its continuous disclosure obligations, ASIC may issue an infringement notice by:

1. If the entity is listed, consulting with the market operator,<sup>10</sup> to ensure consistent interpretation of the provisions by ASIC and market operators (such as the ASX);
2. sending the disclosing entity a letter setting out its reasons for believing that the entity has contravened the provisions;<sup>11</sup>
3. conducting a private hearing, giving the entity the opportunity to give evidence and make submissions;<sup>12</sup>
4. if ASIC has reasonable grounds to believe, after the hearing, that the entity has contravened the provisions, serving an infringement notice on the entity.<sup>13</sup> This notice must include details of the contravention, the amount to be paid by the entity, the effect of compliance and the effect of the entity's failure to comply.<sup>14</sup>

Compliance with the notice requires payment of the designated penalty and disclosure of the relevant information<sup>15</sup> within 28 days<sup>16</sup> and does not constitute an admission of guilt and results in non-

1 Commonwealth Treasury, Review of the Operation of the Infringement Notice Provisions of the Corporations Act 2001, March 2007, available at

[http://www.treasury.gov.au/documents/1198/PDF/Review\\_of\\_Infringement\\_Notice\\_Provisions.pdf](http://www.treasury.gov.au/documents/1198/PDF/Review_of_Infringement_Notice_Provisions.pdf); Commonwealth Treasury, Insider Trading, Position and Consultation Paper, March 2007, available at [http://www.treasury.gov.au/documents/1235/PDF/Insider\\_trading\\_position\\_consultation.pdf](http://www.treasury.gov.au/documents/1235/PDF/Insider_trading_position_consultation.pdf); and Commonwealth Treasury, Review of Sanctions in Corporate Law, March 2007, available at [http://www.treasury.gov.au/documents/1182/PDF/Review\\_of\\_Sanctions.pdf](http://www.treasury.gov.au/documents/1182/PDF/Review_of_Sanctions.pdf),

all accessed 21 May 2007.

2 Sons of Gwalia Ltd v Margaretic; ING Investment Management LLC v Margaretic [2007] HCA 1.

3 CAMAC, [http://www.camac.gov.au/camac/camac.nsf/byHeadline/PDF/Refere\\_nce/\\$file/Ref\\_Sons\\_of\\_Gwalia.pdf](http://www.camac.gov.au/camac/camac.nsf/byHeadline/PDF/Refere_nce/$file/Ref_Sons_of_Gwalia.pdf), 6 February 2007; accessed 21 May 2007.

4 As at 21 May 2007.

5 Commonwealth Treasury, Review of the Operation of the Infringement Notice Provisions of the Corporations Act 2001, March 2007, available at [http://www.treasury.gov.au/documents/1198/PDF/Review\\_of\\_Infringement\\_Notice\\_Provisions.pdf](http://www.treasury.gov.au/documents/1198/PDF/Review_of_Infringement_Notice_Provisions.pdf); accessed 21 May 2007.

6 which were introduced into the Corporations Act (Cth) 2001 by the Corporate Law Economic Reform Program (Audit Reform and Corporate Disclosure) Act 2004, which commenced on 1 July 2004.

7 Defined in various tests located in Division 2 of Part 1.2A of the Corporations Act.

8 Located in Chapter 6CA of the Corporations Act.

9 For criminal liability, see subsections 674(2) and 675(2), and Schedule 3; for civil penalties, see subparagraphs 1317E(1)(ja) and 1317G(1B)(b).

10 Subsection 1317DAD(2) of the Corporations Act.

11 Subparagraph 1317DAD(1)(a) of the Corporations Act.

12 Subparagraph 1317DAD(1)(b) of the Corporations Act.

13 Subsections 1317DAC(1) and 1317DAC(2) of the Corporations Act.

14 See section 1317DAE.

15 Section 1317F.

16 Section 1317DAH.

contravention of the relevant obligations;<sup>17</sup> however the entity remains liable to compensate any person who has suffered loss as a result of the contravention.<sup>18</sup>

Non-compliance is not enforceable in the courts, but ASIC remains able to access other remedies under the Corporations Act, namely to initiate civil penalty proceedings or criminal proceedings in respect of the contravention. ASIC may also seek an order requiring disclosure of the information.<sup>19</sup>

ASIC may not disclose details of an infringement notice until it is complied with.<sup>20</sup> The consultation paper notes that five such notices have been complied with.<sup>21</sup> This number seems low. We can only presume that in most cases where a notice is issued, the submissions of the relevant disclosing entity manage to satisfy ASIC that the provisions have not been contravened.

The consultation paper calls for submissions on the following points:

What has been your experience of the infringement notice process?

Do you think that this additional tool has resulted in greater compliance with the continuous disclosure provisions?

Should the infringement notice provisions be amended to improve the usefulness or fairness of the mechanism?<sup>22</sup>

### **Discussion Paper: Sanctions**

The second discussion paper issued by Treasury is entitled 'Review of Sanctions under Corporate Law'.<sup>23</sup> It identifies the following two areas for potential reform:

1. expanding the types of sanctions imposed for breaches of corporate law; and
2. clarifying the circumstances in which a sanction could be imposed.

The Government also invites submissions (before 1 June 2007) on whether the current sanction regime inhibits decision-making and represents an appropriate balance between the need to deter

inappropriate conduct and to not deter appropriate business conduct.<sup>24</sup> Submissions are specifically requested as to whether current investor protection is at the expense of entrepreneurship – thus opening the door for a wide-ranging review of current corporate law sanctions.

After submissions close, the Treasury will provide preliminary advice to the Treasurer, who will identify issues warranting further development and establish an advisory group to prepare a proposals paper for consideration by the Treasurer.<sup>25</sup>

### **Background**

The purpose of sanctions is to:

- discourage undesirable behaviour that might reduce the efficiency and development of the economy;
- facilitate responsible risk taking and innovation; and
- provide the regulator with the flexibility to tailor a regulatory response to the circumstances of a breach.<sup>26</sup>

The following sanctions currently available under the Corporations Act are:

- criminal sanctions, attracting fines of up to \$220,000 and imprisonment for up to 10 years. Minor offences can incur a fine called a penalty notice, payment of which precludes criminal proceedings;
- civil penalties of up to \$200,000 (or \$1 million for a body corporate in relation to a breach of the financial services civil penalty provisions). Compensation orders can be imposed in respect of a contravention of a civil penalty provision, which include breach of officers' duties, insolvent trading and continuous disclosure provisions;
- an order banning a person from managing corporations or providing financial services, where they have contravened a criminal provision or civil penalty provision, and in certain other circumstances;
- enforceable undertakings, which ASIC may accept in respect of any matter in relation to which ASIC has a function or power. Breach of an enforceable undertaking entitles ASIC to seek court orders compelling compliance with the undertaking, without needing to establish the original contravention of the underlying legislation;
- infringement notices, discussed above.<sup>27</sup>

<sup>17</sup> Section 1317DAF(4).

<sup>18</sup> Sections 1317DAF(6) and 1317HA.

<sup>19</sup> Section 1324B.

<sup>20</sup> Section 1317DAJ.

<sup>21</sup> Pages 7-8.

<sup>22</sup> *Ibid* above n.5, 8.

<sup>23</sup> Commonwealth Treasury, Review of Sanctions in Corporate Law, March 2007, available at [http://www.treasury.gov.au/documents/1182/PDF/Review\\_of\\_Sanctions.pdf](http://www.treasury.gov.au/documents/1182/PDF/Review_of_Sanctions.pdf), accessed 21 May 2007.

<sup>24</sup> *Ibid* 1-2.

<sup>25</sup> *Ibid* viii.

<sup>26</sup> *Ibid* 3.

<sup>27</sup> *Ibid* 7-9.

These regulatory sanctions operate concurrently with the personal rights of private persons to pursue private remedies against companies, either in respect of personal rights, or through a statutory derivative action.<sup>28</sup>

### **Part One: corporate law sanctions and their effect on business**

The first part of the paper reviews the various models underpinning debates in regulatory theory. The 'deterrence model' is characterised by a belief that compliance with the law occurs only due to the existence of sanctions and penalties. The Government outlines this model:

Individuals and corporations are seen to be 'rational actors', who are motivated entirely by profit-seeking. They carefully assess opportunities and risks, and will breach the law if the expected cost, calculated by reference to the anticipated fine and probability of being caught, are small in relation to the expected benefits in terms of profits to be made through non-compliance. Advocates of this model therefore consider that harsh sanctions and penalties are necessary to ensure compliance. ... [This] model has been criticised on a number of grounds. ... It does not satisfactorily explain the high levels of voluntary compliance ... If people were simply 'rational actors' motivated purely by self-interest, one would expect that compliance ... would be significantly less prevalent than what has been observed.<sup>29</sup>

The 'accommodative model' is characterised by a belief that legal compliance occurs more effectively with persuasion and cooperation with regulatory authorities. The Government states:

The accommodative model views corporations and individuals ... as 'social actors', who are ordinarily inclined to comply with the law, partly because of belief in the rule of law, and partly as a matter of long-term self-interest. Regulatory agencies adopting the accommodative model tend to be more orientated toward seeking compliance outcomes through cooperation rather than by coercion, and prefer to see themselves as consultants rather than as strict law enforcers. These agencies are more likely to give second chances and advice about how to comply. They may also agree to ignore one violation in return for a correction of another violation.<sup>30</sup>

The Government acknowledges the following difficulties with these models:<sup>31</sup>

- 'a predominantly punitive policy fosters resistance to regulation and may produce a

28 Under sections 236-239 of the Corporations Act, which permit a member of a company, acting in good faith, to seek court approval to participate in legal proceedings on behalf of the company.

29 Ibid n.23, 4.

30 Ibid n.23, 5.

31 Ibid, 5, sourced from ANU's Centre for Tax System Integrity, Working Paper 45 of November 2004: *Moving towards a more effective model of regulatory enforcement in the Australian Taxation Office*, p 3.

culture that facilitates the sharing of knowledge about methods of legal resistance';

- laws promoting 'a 'tick the box' approach to compliance' may weaken 'the ethical sinews of society' by giving participants no choice in how to act – depriving them of the choice of choosing to act in a manner which is right;
- punitive regulation can appear 'unreasonable', causing a reduction in the willingness in even well-intentioned individuals to comply; and
- a purely accommodative model is naïve, as there will be dishonest individuals who would use a presumption of honesty to their own advantage.

The Government reviews literature relevant to these models, including Braithwaite's rejection<sup>32</sup> of each model, and the proposal by Braithwaite and Ayres<sup>33</sup> that the two models converge in a third model known as 'responsive regulation', which attempts to 'strike a sophisticated and dynamic balance between the deterrence and accommodative models of regulation'.<sup>34</sup> The Government goes on to state:

"The basic question for responsive regulation is not whether to punish or persuade, but when to punish and when to persuade. A key concept of the Ayres and Braithwaite model is that, although the regulator should have access to severe punishments, they should rarely need to use them in practice if they ensure that it is economically rational for the regulated to cooperate. Where breaches occur, the initial response should be to persuade and educate the transgressor on appropriate behaviour—this promotes self-regulation and the wish to preserve reputation. However, once persuasion has failed, there should be punishment and the question then becomes the type of penalty applicable'.<sup>35</sup>... 'Ayres and Braithwaite argue that regulatory agencies are best able to secure compliance when they are 'benign big guns'.<sup>36</sup> That is, they will be more able to speak softly when they carry big sticks and, crucially, a hierarchy of lesser sanctions. The bigger and more various the sticks, the greater the success regulators will achieve by speaking softly.

The Government notes that the 'need for resort to severe punishments in some circumstances ... must be balanced against the potential for severe penalties to have a 'freezing effect' on responsible risk taking and commercial decision making'<sup>37</sup> and

32 Braithwaite, J 1985 *To Punish or Persuade: Enforcement of Coal Mine Safety*. Albany: State University of New York Press cited at ibid n 23, 5.

33 Braithwaite, J Ayres, I *Responsive Regulations: Transcending the Deregulation Debate*, Oxford University Press 1992, cited at ibid n 23, 5.

34 Ibid n 23, 5.

35 Ibid 6, citing The Australian Law Reform Commission, Principled Regulation Report: *Federal Civil and Administrative Penalties in Australia*, December 2002, paragraphs 3.34, 3.35.

36 Ibid 6, citing Braithwaite, J Ayres, I, ibid n 33.

37 Ibid n 23, 8.

refers to the report by the Taskforce on Reducing Regulatory Burden on Business (the Banks Taskforce), where it 'reported the magnitude of penalties attaching to breaches of regulation have been a major driver of a regulated entity's approach to managing risks'.<sup>38</sup> The Government refers to the Taskforce's caution that:

A risk-averse approach by business may limit ... willingness to adopt innovative approaches ... [and] would also be reflected in an overly cautious approach to compliance .... This would undermine the overall efficiency and dynamism of the economy.<sup>39</sup>

The Government asks for submissions on the following general questions relating to the regime of sanctions under the Corporations Act and their effect on the making of business decisions:

1. Are you aware of any situations where the prospect of potential sanctions influenced a decision about whether to engage in a certain business activity? If so, which provision gave rise to the concern, and was this concern due to uncertainty about how the law operated or due to the prospect of imprisonment or personal liability for something you considered to be out of your control?
2. Are you aware of any situation where the absence of sufficient sanctions influenced a decision about whether to engage in a certain business activity?
3. Does the regime for corporate regulation in Australia deter responsible risk-taking more or less than is the case in other comparable jurisdictions?
4. Has the law gone too far to protect investors, at the cost of entrepreneurship? Are there areas where the law has not gone far enough?

## Part Two: Civil, Administrative and Criminal Sanctions

The Corporations Act includes three main categories of sanction: criminal, civil and administrative sanctions. The Government suggests changing the current balance (where criminal sanctions are the default option) so that only serious wrongdoing attracts criminal sanctions.<sup>40</sup> The Government questions whether the current approach, where:

criminal sanctions [are] to be used as a "default" option, with the alternative of civil procedures applying in a

limited number of situations where it may be practically difficult to prove all elements of the criminal offence<sup>41</sup>

is 'the most effective means of achieving optimum compliance'<sup>42</sup> given potential inconsistency with the recommendation of the Australian Law Reform Commission (ALRC) that:

caution should be exercised in extending the criminal law into regulatory areas unless the conduct that is being proscribed clearly merits the moral and social censure and stigma that attaches to conduct regarded as criminal.<sup>43</sup>

### **Criminal sanctions**

The Government notes that the traditional characteristic of a crime is 'the repugnance attached to the act which invokes social censure and shame'<sup>44</sup> and argues that:

criminal sanctions should be:

- used only to censure people for substantial wrongdoing;
- enforced with respect for equal treatment and proportionality; and
- proportionate to the seriousness of the wrongdoing.<sup>45</sup>

The Government also notes that criminal sanctions in Commonwealth legislation:

are often directed at addressing behaviours ... outside the traditional scope of the criminal law — that is, misconduct that lacks those elements of causing serious harm to others or contravening society's fundamental values.<sup>46</sup>

This raises two main concerns:

- the 'mental element'<sup>47</sup> typically required for criminal offences, does not always apply to regulatory offences. The inability to distinguish between intentional offenders, and those making best efforts to comply, can cause 'innocent' offenders to resent the law and can also lead to

<sup>41</sup> Ibid.

<sup>42</sup> Ibid.

<sup>43</sup> Ibid n 23, 13, citing The Australian Law Reform Commission, *Principled Regulation Report: Federal Civil and Administrative Penalties in Australia*, December 2002, at paragraph 3.110.

<sup>44</sup> Ibid n 23, 13, citing The Australian Law Reform Commission, *Principled Regulation Report: Federal Civil and Administrative Penalties in Australia*, December 2002, at paragraph 2.10.

<sup>45</sup> Ibid n 23, 14, citing Ashworth, A. 'Is the Criminal Law a Lost Cause?' (2000) *Law Quarterly Review* 116.

<sup>46</sup> Ibid n 23, 14, citing Australian Law Reform Commission, *Principled Regulation Report: Federal Civil and Administrative Penalties in Australia*, December 2002, at paragraph 2.8.

<sup>47</sup> The *Criminal Code Act 1995* provides for four types of fault: intention, knowledge, recklessness and negligence. The Act also provides that strict liability is an alternative to fault. Some examples of the application of strict liability in the *Corporations Act 2001* are sections 448C, 448D and 471A.

<sup>38</sup> Ibid 9.  
<sup>39</sup> Ibid 10.  
<sup>40</sup> Ibid 13.

criminal convictions losing their stigma<sup>48</sup> and thus their deterrent effect;

- the inappropriateness of imprisonment for some of the offences currently attracting that sentence. The primary value of imprisonment as a sanction stems from its 'perception as the ultimate sanction'.<sup>49</sup> The Government notes the ALRC's recommendation that imprisonment should not be a sentencing option for certain offences, particularly in an absence of systematic fraud.<sup>50</sup> It also notes the Senate Scrutiny of Bills Committee's criticism of often punishing offences relating to the provision of information with imprisonment, even in the absence of intentional misleading statements for financial gain or intentional prejudice of a quasi-criminal investigation.<sup>51</sup>

Imprisonment for corporate law offences has also been criticised in that it allows imprisonment to occur for periods less than six months. This is contrary to the Guide to Penalties, which recommends a minimum term of six months if imprisonment is considered to be an appropriate penalty, so as to preserve imprisonment as a serious penalty for the serious cases, and to avoid burdening prisons with minor offenders.<sup>52</sup>

The Government proposes to review the use of criminal sanctions, so that they are no longer the default sanction for breaches of the Corporations Act, instead only applying where the wrongdoing is 'serious' or 'substantial', for example:

wrongdoing that is intentional or repeated, or that it would have an effect or potential effect on the market that warrants the strongest deterrent or punishment, or that market participants would expect an element of retribution for the wrongdoing.<sup>53</sup>

The Government suggests that 'more targeted use of criminal sanctions would address concerns that some requirements under corporate law are procedural or mechanical in nature'.<sup>54</sup> Given the high costs of criminal prosecutions, the Government suggests that 'alternatives should be explored where this would not undermine the policy intent of the substantive provision'.

The Government also suggests limiting imprisonment as a punishment to offences where an

48 Ibid n 23, 13-15.

49 Ibid 15-16, citing Law Reform Commission, Report no. 44, Sentencing, Australian Government 1988.

50 Ibid.

51 Ibid.

52 Ibid.

53 Ibid 16-17.

54 Ibid 17.

offence is 'sufficiently serious to warrant a maximum term of imprisonment of six months or more', and more generally to review the magnitude of criminal penalties.<sup>55</sup>

### Civil penalties

Civil penalties were intended to provide flexibility in enforcement of the law; submissions are invited as to whether the scope of their application (and/or the amount of those sanctions) should be increased.

The Government notes the extension of civil law's traditional focus on private wrongs not involving public retribution or compensation<sup>56</sup> by application of civil law processes and procedures to actions invoked by the state.<sup>57</sup> The Government observes that the dual purposes of deterrence and punishment apply equally to civil sanctions, but distinguishes the two based on:

- the greater role of intent in the criminal law, with its emphasis on subjective awareness rather than objective reasonableness;
- the criminal law's focus on risk creation, rather than actual harm;
- the criminal law's insistence on greater evidential certainty and lesser tolerance of procedural informality;
- the criminal law's reliance on public enforcement, tempered by prosecutorial discretion; and
- the criminal law's deliberate intent to inflict punishment in a manner that maximises stigma and censure.<sup>58</sup>

By deterring, without the stigma of a criminal conviction, civil sanctions:

therefore provide additional options for policy makers seeking to strike a balance between deterring undesirable conduct and not deterring desirable conduct, while minimising overall enforcement costs.<sup>59</sup>

The Government observes that:

- civil actions can be easier to prosecute, owing to an easier burden of proof and procedural protections for defendants;<sup>60</sup>
- criminal actions may have greater deterrent and punishment effect, despite the higher fines available for civil actions, due to the stigma of a criminal conviction.<sup>61</sup>

55 Ibid.

56 Ibid, citing Senate Standing Committee on Legal and Constitutional Affairs Report, *Social and Fiduciary Duties and Obligations of Company Directors* 1989 at paragraph 2.3.

57 Ibid n 23, 17.

58 Ibid 18.

59 Ibid 18, citing The Australian Law Reform Commission, Principled Regulation Report: *Federal Civil and Administrative Penalties in Australia*, December 2002, at paragraph 2.60.

60 Ibid.

61 The Australian Law Reform Commission, *Principled Regulation Report: Federal Civil and Administrative Penalties in Australia*, December 2002, paragraph 3.69.

The Government proposes to extend the current civil penalty regime (which involves a court declaring that a contravention has occurred; which then empowers the court to make an order for the payment of a pecuniary penalty and/or a compensation order, and to order, if appropriate, that the person involved is banned from managing corporations for a specific time) to offences currently covered by criminal sanctions.

The Government suggests:

Where an existing criminal strict liability offence is replaced with a civil offence, it is proposed that potential orders would be considered on a case by case basis. In many cases, it may be that it would be sufficient to limit potential orders to pecuniary penalties.<sup>62</sup>

Criminal penalties which are low in comparison to the prospective rewards of illegal behaviour can lessen the 'deterrent value' of sanctions;<sup>63</sup> however, other deterrents exist – such as exposure to legal action for breach of duties or removal from office.<sup>64</sup> The report suggests that the amount of a penalty could be more appropriately fixed having regard to the gain resulting from a breach, or an offender's net worth.<sup>65</sup> Other alternative sentencing options suggested by the ALRC for federal offences are:

- orders preventing the undertaking certain commercial activities;
- corrective action within the offending organisation;
- activities for the benefit of the community;
- publication of offending conduct;
- dissolution of an offending corporation,<sup>66</sup>

although some of these may unfairly impact on shareholders, creditors, customers and employees of an offending corporation.<sup>67</sup>

### **Administrative sanctions**

These are sanctions where liability and penalty are both strictly defined in the legislation, and the penalty is imposed by the regulator as a matter of law without the intervention of a court, although a

right of appeal to an independent tribunal (such as the AAT) or a court exists.<sup>68</sup>

The utility of administrative sanctions lies in their ability to reduce legislative complexity and enforcement costs. This allows a greater proportion of breaches to be pursued, resulting in a larger deterrent effect and greater compliance.<sup>69</sup> In addition, a lesser stigma attaches, and the penalty can be more proportionate.<sup>70</sup>

The Government suggests that such sanctions 'may be suited to minor breaches, involving strict or absolute liability, and no forensic inquiry', for example:

- breach of section 143 (obligation of a company not occupying the premises of its registered office to be able to show the occupier's written consent to that use of the premises, breach of which currently attracts 5 penalty units (\$550);
- breach of section 144 (obligation of a company to display its name prominently at every place at which it carries on business and is open to the public, breach of which attracts 10 penalty units (\$1,100), or 3 months imprisonment, or both);
- breach of section 172 (obligation to notify ASIC of the location of company registers within 7 days of establishment / moving, breach of which attracts 10 penalty units (\$1,100), or 3 months imprisonment, or both);
- breach of subsections 205B (1), (2), (4) and (5) (the obligation to notify ASIC of new directors or secretaries (or changes in their details) within 28 days, attracting a penalty of 10 penalty units (\$1,100), or 3 months imprisonment, or both).<sup>71</sup>

### **Consultation Issues about sanctions**

The Government specifically asks for consultation on the following questions:

- Should criminal sanctions only apply where there is an effect or potential effect on the integrity of the market that warrants the severest condemnation or punishment, and/or where the market would expect an element of retribution, and/or where a breach is intentional or reckless?
- Should strict liability offences be limited to situations where:

<sup>62</sup> Ibid n 23, 20.

<sup>63</sup> Ibid 21, citing The Australian Law Reform Commission, Principled Regulation Report: *Federal Civil and Administrative Penalties in Australia*, December 2002, paragraph 8.9.

<sup>64</sup> P 21 citing Corporations and Markets Advisory Committee, *Personal Liability for Corporate Fault* September 2006. Derivative actions may be brought under sections 236-242 of the *Corporations Act 2001*.

<sup>65</sup> Ibid n 23, 21-22.

<sup>66</sup> Ibid 22 citing Australian Law Reform Commission Report 103, *Same Crime, Same Time: Sentencing of Federal Offenders*.

<sup>67</sup> Ibid n 23, 22.

<sup>68</sup> Ibid 24.

<sup>69</sup> Ibid 24-25.

<sup>70</sup> Ibid 25.

<sup>71</sup> Ibid 26.

- (a) the offence is not punishable by imprisonment and is punishable by a fine of up to 60 penalty units for an individual (300 for a body corporate);
  - (b) the punishment of offences not involving fault is likely to significantly enhance the effectiveness of the enforcement regime in deterring offences; or
  - (c) legitimate grounds exist for penalising persons lacking 'fault', for example because they will be placed on notice to guard against the possibility of any contravention?
- Should imprisonment only be retained as a penalty for serious criminal offences with the maximum term being at least six months?
  - Should greater use be made of civil sanctions for breaches of corporate law? If so, should civil sanctions apply:
    - (a) Where misconduct affects or potentially affects the integrity of the market, but there is an absence of intention in the conduct that makes the offence less egregious than an offence attracting a criminal sanction?
    - (b) Where strict liability applies to all elements of an offence?
  - Should there be an increase, or a reduction, in the amount of civil pecuniary penalties? If maximum pecuniary penalties are thought to be inadequate, would alternative options like those proposed for the Trade Practices Act 1974 be appropriate in corporate law?
  - Should the rules of procedure to be adopted by the courts in civil proceedings under the Corporations Act be more clearly defined in the Act? If so, should they be the same as the rules followed in civil remedial actions or should they be some type of hybrid between criminal and civil procedure?
  - Are there any particular privileges available under the criminal law that should be abrogated in civil actions?
  - Is there scope in corporate law for administrative sanctions to apply to breaches of low level record keeping and reporting provisions? Are there any types of misconduct within these low level offences to which administrative sanctions should not apply?<sup>72</sup>

<sup>72</sup> Ibid 26-28.

## Part Three: Directors' duties

### Reforming defences

Currently, directors' primary defence against liability for 'failure to exercise their powers and perform their duties with skill and diligence'<sup>73</sup> is the business judgment rule in section 180(2) of the Corporations Act, which provides a defence where a business judgement was made for a proper purpose, without a material personal interest in the subject matter of the judgment and after obtaining sufficient information about the subject matter of the judgment.

The Government queries whether board unwillingness to 'engage in responsible risk taking'<sup>74</sup> could be addressed by providing a 'consistent defence' for directors who act bona fide, within the scope of the company's business, reasonably and incidentally to the company's business, and for the company's benefit.<sup>75</sup> This could be introduced if the benefit of 'additional certainty for directors about the legality of their actions' outweighs the detriment of additional complexity and costs of an action for breach of directors' duties.<sup>76</sup>

The Government suggests that the primary benefit of the introduction of a general defence would be to reduce the risk of liability for directors associated with corporate decision making, and acknowledges the primary need for this defence is in relation to:

the 'core' duties in relation to good faith, care and diligence, use of position and use of information in sections 180-183 of the Corporations Act, and the duty to avoid insolvent trading in section 588G.<sup>77</sup>

The Government queries whether such a defence should be extended to more 'mechanical' duties, such as reporting obligations. Queries have also arisen in relation to insolvent trading, where the availability of a defence could arguably lead to greater willingness to trade insolvently (although it could be equally argued that such behaviour would no longer satisfy the bona fide criterion for the defence to apply).<sup>78</sup>

The Government specifically asks for consultation on the following questions:

- Whether the introduction of a general defence would improve the balance between

<sup>73</sup> Section 180(1) of the Corporations Act

<sup>74</sup> Ibid n 23, 29.

<sup>75</sup> Ibid.

<sup>76</sup> Ibid.

<sup>77</sup> Ibid 30.

<sup>78</sup> Ibid 32.

discouraging undesirable conduct and promoting responsible risk taking?

- Whether the proposed elements of the general defence are correct, or do any particular concepts in the general defence require further consideration or elaboration?
- Whether the general defence should apply to the 'core' duties in sections 180-183 and section 588G? Specifically:
  - (a) Are there any adverse consequences that may result from a general defence applying to the duties of use of position (section 182) and use of information (section 183)?
  - (b) Would an extension of the general defence to the insolvent trading provisions encourage insolvent trading? Would an extension be to the detriment of creditors?
  - (c) If the general defence is applied to the duty to exercise care and diligence (section 180), is there a need to clarify its interaction with the business judgement rule in subsection 180(2)?
  - (d) If the general defence is applied to the insolvent trading provisions, is there a need to clarify its interaction with the existing defences?
- Should the general defence apply to those strict liability offences that are intended to protect shareholders interests?
- The business judgment rule in subsection 180(2) also applies to equivalent duties at common law and in equity. Should a general defence also apply as a defence to actions brought in relation to equivalent duties at common law or equity?<sup>79</sup>

### **Reforming other aspects of the Corporations Act**

In addition, the Government queries:

- whether uniformity in the tests of good faith in sections 181 (an objective test to act in the company's best interests) and 180 (a subjective rational belief that the judgment is in the best interests of the company) is desirable;<sup>80</sup>
- whether section 189 (which provides that it is reasonable for a director to rely on information provided by others if the director has made an independent assessment of the information) should be amended to achieve consistency with the phrasing of section 190;<sup>81</sup>

<sup>79</sup> Ibid 32-33.  
<sup>80</sup> Ibid 33.  
<sup>81</sup> Ibid 36.

- whether the penalties for breach of section 286 (the obligation to keep accurate financial records) should be increased, to operate as a more effective deterrent;<sup>82</sup>
- whether specifying the maximum penalty within a provision in the Corporations Act would improve understanding and clarity of offence provisions?<sup>83</sup>

Whether any confusion is caused to do inconsistency with requirements under the Criminal Code, or where defences replicate defences under the Criminal Code?<sup>84</sup>

## **Part Four: Market Manipulation**

The Government describes the effect of subsection 1041B(2) as deeming a defendant:

to have created a false or misleading appearance of active trading where the defendant acquires or disposes of financial products with no change of beneficial ownership, or makes matched orders to acquire and dispose of financial products,<sup>85</sup>

which may render a defendant liable for conduct that neither created a false or misleading appearance to the market or was for an illegitimate purpose. In addition, the Government notes some confusion as to whether the 'mental' element required for Criminal Code offences applies to such conduct and in particular, whether the necessary intention or recklessness must go to the misleading effect of the conduct, or simply whether the trades occurred in breach of section 1041B.<sup>86</sup> The Government gives the following example:

...the case of a defendant who sells a small parcel of shares at the end of the tax year purely to crystallise tax losses, then immediately buys them back at the same price. The transaction is not intended to create a misleading appearance and the market is not misled. If the second view is correct, the defendant would be deemed to have created a false or misleading appearance and would be criminally liable.<sup>87</sup>

The Government specifically asks for consultation on the following questions:

- Whether section 1041B should be amended to clarify the circumstances in which someone is criminally liable, as a result of the combined effects of section 5.6 of the Criminal Code and the deeming provision in subsection 1041B(2) of

<sup>82</sup> Ibid 37.  
<sup>83</sup> Ibid 39.  
<sup>84</sup> Ibid 39.  
<sup>85</sup> Ibid 42.  
<sup>86</sup> Ibid 39-40.  
<sup>87</sup> Ibid 40.

the Corporations Act? And if so, would it be appropriate to amend the section so a person is criminally liable:

- (a) if that person intended or was aware or was reckless that matched trades or a trade without change of beneficial ownership would occur; or
  - (b) if that person intended or was aware or reckless that a false or misleading appearance would occur?
- Whether the circumstances in which criminal liability is incurred as a result of the application of subsection 1041B(2) should be amended, so that a person is criminally liable without needing to prove any knowledge, intent or recklessness, but has a defence if it is proved that the purpose or purposes for which the person did the act was not, or did not include, the purpose of creating a false or misleading appearance of active trading in particular financial products on a financial market?
  - Whether there should be a change to the circumstances in which civil liability is incurred as a result of the application of subsection 1041B(2)? And if so, whether it would be appropriate that civil liability is incurred:
    - (a) if a person intended or was aware or reckless that matched trades or a trade without change of beneficial ownership would occur; or
    - (b) if a person intended or was aware or reckless that a false or misleading appearance would occur; or
    - (c) without needing to prove any mental element, as at present, but allowing a defence if it is proved that the purpose or purposes for which the person did the act was not, or did not include, the purpose of creating a false or misleading appearance of active trading in particular financial products on a financial market; or
    - (d) as now, but giving the Court the discretion not to make a declaration of contravention where a person has contravened section 1041B?<sup>88</sup>

Although submissions close on 1 June 2007, the Government notes an expectation that the issues discussed in the paper will be further explored during roundtable discussions in July 2007, to be reported to the Treasurer in August 2007, and likely subsequent establishment of an advisory group tasked with producing a consultation paper in around November 2007. These issues are not going to go away.

<sup>88</sup> Ibid 42.

### **Position and Consultation Paper: Insider Trading**

The third discussion paper<sup>89</sup> asks for submissions on the Government's position on insider trading recommendations made by the Corporations and Markets Advisory Committee in November 2003.<sup>90</sup> The Government accepts most of CAMAC's recommendations, but asks for consultation and submissions in relation to some of its recommendations. Submissions may be made until 2 June 2007.

The following CAMAC recommendations, set out in Appendix A, have been accepted by the Government.<sup>91</sup>

#### **Miscellaneous**

(1) Strengthen the reporting requirements for directors, by amending s 205G:

- to apply to all listed entities (but deeming exempt foreign entities to have complied if their directors have complied with disclosure requirements of their incorporating jurisdiction);
- to apply to all directors and senior executives including the chief executive officer, and covering direct trading and trading through related parties, and directors and senior executives of any entity that substantially manages the affairs of a listed entity;
- to cover transactions that occurred before a director's resignation and within one month thereafter;
- with off-market transactions, a copy of the contract should also be disclosed;
- to disclose the closest approximate number of securities whenever it is not reasonably possible to know the exact number;
- to reduce the disclosure period from 14 days to 2 business days, except for changes arising under dividend (distribution) re-investment plans;
- to not require disclosure of changes arising from transactions applying equally to all shareholders, without individual shareholder election;

(4) Clarify the relevant time for liability when trading through an intermediary - when instructions are given to the intermediary; the instructor should not

<sup>89</sup> Commonwealth Treasury, *Insider Trading: Position and Consultation Paper*, March 2007, available at [http://www.treasury.gov.au/documents/1235/PDF/Insider\\_trading\\_position\\_consultation.pdf](http://www.treasury.gov.au/documents/1235/PDF/Insider_trading_position_consultation.pdf); accessed 21 May 2007.

<sup>90</sup> CAMAC, *Insider Trading Report*, November 2003, available at [http://www.camac.gov.au/camac/camac.nsf/byHeadline/PDFFinal+Reports+2003/\\$file/Insider\\_Trading\\_Report\\_Nov03.pdf](http://www.camac.gov.au/camac/camac.nsf/byHeadline/PDFFinal+Reports+2003/$file/Insider_Trading_Report_Nov03.pdf); accessed 21 May 2007.

<sup>91</sup> Ibid n 89, 4-8 and 25-30. The numbering refers to the number allocated to that recommendation in the CAMAC report, *ibid*.

contravene the provision unless a transaction takes place.

(5) Extend the Chinese Walls defence to cover the procuring offence

(6) Permit bid consortium members to acquire for the consortium, by amending the 'own intentions' exemption to clarify that members of a prospective bid consortium can acquire on behalf of that consortium prior to the market becoming aware of the intended bid. However, these persons should not be entitled to trade on their own behalf before the market becomes aware of the bid, even with the consent of other bid consortium members.

(7) Protect uninformed procured persons from civil liability, so that they should not be required to return any profit made or loss avoided by that person if they establish that the procuring insider did not receive any direct or indirect benefit from that transaction.

(8) Extend the equal information defence to civil proceedings, by providing an equal information defence in civil proceedings similar to the defence that applies in criminal proceedings, namely that the counterparty to the transaction 'knew or ought reasonably to have known' of the inside information.

(9) Permit courts to extend the range of civil claimants who have traded in the market beyond the insider's immediate market counterparty, using the concept of 'aggrieved persons'.

(12) To entitle uninformed party requiring the exercise of option rights, whether or not fixed price, to require their informed counterparties (that is, anyone who holds inside information at the time of exercise) to honour their physical delivery obligations.

### **Exclusions to the application of the insider trading provisions**

(13) The Majority considers that issuers making a general issue should not be subject to the insider trading provisions. (The Minority does not support this exemption).

The Advisory Committee considers that offerees who subscribe for new issues when aware of inside information not known to the issuer should remain subject to the insider trading provisions.

(15) Insider trading provisions should still apply to offerees under share buy backs.

(16) Transactions under non-discretionary trading plans (majority position) should be exempt from the insider trading provisions where:

- the trading takes place in accordance with a plan entered into when either the person was not aware of any inside information or any information of which the person was then aware was no longer inside information when any trading under the plan took place;
- there are no discretions under the plan, other than to terminate it; and
- the plan was entered into in good faith and not as part of a scheme to evade the insider trading prohibitions.
- The person relying on the exemption has the legal onus of establishing the above elements, rather than merely an evidential onus to raise them.

### **Recommendations that the law not change**

In addition, the Government agreed with CAMAC's recommendations that the following aspects of the law not be amended.<sup>92</sup>

(17) The 'insider' definition should still include entities as well as natural persons.

(18) The 'information connection' approach, without any additional 'person connection' test, should be retained.

(19) There should be no rebuttable presumptions.

(20) Decisions not to trade, disclosing inside information for that purpose and procuring another person not to trade, should continue to be excluded from the insider trading legislation.

(21) There should be no obligation to inform recipients that information is inside information.

(22) There should be no requirement that inside information be specific or precise.

(23) Apart from the recommended exemption for informed persons trading pursuant to a pre-existing non-discretionary trading plan (recommendation 16), the insider trading legislation should not have a use requirement or a defence of non-use.

<sup>92</sup> Ibid n 89, 4-8 and 25-30.

(24): There should be no defence that an informed person traded contrary to inside information.

(25): The communication and subscription exemptions for underwriting should be retained.

(26): An intermediary who is aware that a client holds inside information should remain liable for aiding and abetting by trading in affected financial products for that client.

(27): There should be no exemption for informed intermediaries acting for uninformed clients.

(28) There should be no derivative civil liability provision.

(29) There should be no specific exemption for target company directors in communicating inside information to white knights.

(30) There should be no statutory exemption for white knights of takeover target companies.

(31) Exchanges should not be obliged to publish any details of their referrals to ASIC of suspected insider trading.

(32) There should not be different criminal and civil insider trading regimes.

(33) CAMAC did not formally recommend whether ASIC should have a power to impose administrative penalties for insider trading. However, it considered that any further debate on this issue should take into account the recommendations in the ALRC Report, *Principled Regulation: Federal Civil and Administrative Penalties in Australia*, that deal with procedural fairness and review of administrative decision making. The Government does not intend to extend infringement notices to insider trading at this time.<sup>93</sup>

(34) The existing rules for assessing the profit made or loss avoided should remain.

(35): The existing law, under which companies whose financial products are traded are entitled to compensation, should remain, even where those companies have suffered no loss or damage.

(36): There should be no new statutory prohibition on speculative trading.

(37) There should be no specific statutory prohibition on short swing profits.

<sup>93</sup> Ibid n 89, 6.

### **Issues for consultation:**

The Government seeks consultation on the following CAMAC recommendations:<sup>94</sup>

(2) whether to restrict the on-selling exemption for underwriters in section 1043C, given the apparent conflict between fairness to counterparties and market efficiency. Specifically, the Government asks:

- Are underwriters disadvantaging counterparties by using this exemption?
- Will this recommendation result in less underwriting capacity, increased costs or otherwise impact on issuers' ability to raise funds?

(3): Whether to repeal the exemption under Paragraph 9.12.01(d) of the Corporations Regulations 2001 (which provides that the trading and procuring offence in section 1043A does not apply to transactions entered into by liquidators, personal representatives of deceased persons and trustees in bankruptcy in good faith to perform their official powers), insofar as it applies to external administrators. The Government asks:

- What would be the effect on the willingness and ability of external administrators to perform their roles, and cost of external administrators?
- What is the evidence of external administrators disadvantaging counterparties by using this exemption?
- If the exemption is to be retained, should it be subject to conditions or limitations other than, or as well as, the current requirement that the transaction be in good faith to exercise their official powers?

(11) The majority of CAMAC recommended that persons who, in good faith, entered into fixed exercise price physical delivery option contracts when they were not aware of inside information should be entitled to exercise their physical delivery rights, even where they hold inside information at the time of exercise.

The Government notes that this may give informed persons an advantage over uninformed persons, which is contrary to the market fairness rationale for prohibiting insider trading; in some instances, informed persons may have a fiduciary duty not to publicly release the inside information at the time they must choose whether to exercise their rights; and considers that there appear to be strong

<sup>94</sup> Ibid 8-23 and 31-42.

arguments for retaining the present position — that is, not permitting informed parties to exercise their physical delivery option rights, given the advantage given to persons with inside information. The Government asks whether there are any circumstances in which permitting informed persons to exercise their physical delivery option rights should be allowed?

(13) - (15) Under section 761E and paragraph 1043A(1)(c) of the Corporations Act, the insider trading provisions currently apply to issuers of new financial products (including under a general issue and under a private placement), and to buy-back entities, other than by a registered managed investment scheme (section 1043B).

The Government agrees with CAMAC's majority view that issuers making a general issue of securities should not be subject to the insider trading provisions. However, the government asks:

- Should issuers and wholesale offerees, in the case of placements, be exempt from the insider trading prohibition, as recommended CAMAC's majority?
- What evidence suggests that the insider trading prohibition discourages minimum holding buy-backs, employee share schemes and on-market buy-backs?
- How would application of the buy back provisions affect companies' willingness to undertake minimum holding buy-backs, employee share schemes and on-market buy-backs?

(38) The Government asks for submissions on whether CAMAC's majority proposal to make consequential amendments to meet needs of specific financial markets (particularly OTC markets for financial products), and comments on how to solve these problems if CAMAC's recommendation is not implemented. The amendments suggested by the CAMAC majority are new definitions of 'disclosable information' and 'announceable information' in section 1042A; and new references to such information in section 1043(1) and (2). The Government describes these concerns:

- Potential retrospectivity of the application of the insider trading offence, and the difficulty of determining at a particular time of trading, whether information is or ceases to be 'inside information' according to a list of criteria (eg in continuous disclosure requirements).<sup>95</sup> Also,

often it is not certain whether an entity will publicly announce information that is not required to announce, which could affect trading in other entity's securities. It would thus not be clear whether information is 'announceable information';

- The Commonwealth Attorney-General's Department considers the definitions of 'disclosable information' and 'announceable information' to be insufficiently clear and certain for inclusion as an element of an offence. In particular, the opportunity exists for the ASX to excuse non-compliance with the Listing Rules;
- The amendments may increase the burden imposed on the prosecution and thus in practice may result in fewer successful convictions.

The Government asks for comments on the specific, post-FSR problems with applying the insider trading legislation to particular financial markets and products, and submissions on how these can be legislatively addressed other than by the amendments suggested by the CAMAC majority.

(10) The CAMAC majority recommended replacing the definition of 'information generally available' (which is information that cannot be 'inside information'), with the following new definition: '1042C(1) For the purposes of this Division, information 'is generally available' only if it:

- (a) is accessible to most persons who commonly invest in Division 3 financial products of a kind whose price or value might be affected by the information, or
  - (b) consists of deductions, conclusions or inferences made or drawn from any information referred to in paragraph (a).
- 1042C(1A) Information is deemed to satisfy paragraph (1)(a) if it is disclosed pursuant to any prescribed disclosure procedure.

CAMAC's minority considered that the current published information and readily observable matter tests of when information is generally available should remain, but the 'readily observable matter' test should be modified so that the matter must be observable 'by a cross-section of Australian investors; without resort to technical assistance beyond that likely to be used by a cross-section of investors; and for a reasonable period of time.'

The Government asks whether the definitions should be changed, and if so, whether any of the following options would be appropriate:

- (a) Clarifying the 'readily observable matter' test as recommended by the minority.
- (b) Leaving the question of interpretation to the courts, with the assistance of notes included in

<sup>95</sup> Australian Stock Exchange (ASX) Listing Rule 3.1A and Corporations Regulation 6CA.1.01., and sections 674-675

section 1042C providing examples of what fits within paragraphs 1042C(1)(a) and (b).

- (c) Amending the provisions (as suggested in the second approach in CAMAC's Proposals Paper paras 3.11-3.20) so that matter is readily observable:

if it either is disclosed in a public area or can be observed by the public without infringing rights of privacy, property or confidentiality; even if other users of the market cannot obtain it because of limitations on their resources, expertise or competence or only on payment of a fee; even if it is only available overseas.<sup>96</sup>

### **Release of Exposure Draft - the Financial Sector Legislation Amendment (Simplifying Regulation and Review) Bill 2007**

On 11 May 2007, the Government also released its exposure draft of the Financial Sector Legislation Amendment (Simplifying Regulation and Review) Bill 2007.<sup>97</sup> Submissions close 30 May 2007.

The draft Bill is intended to:

- streamline breach reporting;
- enhance flexibility through exemption powers, enforceable undertakings and discretion under prudential standards;
- simplify processes for appointing actuaries and auditors;
- enhance cooperation between the Australian Prudential Regulation Authority and professional bodies; and
- simplify the *Life Insurance Act 1995* and the *Superannuation Industry (Supervision) Act 1993*.<sup>98</sup>

In part, it is implementing proposals outlined in the Government's proposals paper, released 4 December 2006, entitled *Streamlining Prudential Regulation: Response to 'Rethinking Regulation'*.<sup>99</sup>

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<sup>96</sup> Ibid 22-23.

<sup>97</sup> Financial Sector Legislation Amendment (Simplifying Regulation and Review) Bill 2007, available at [http://www.treasury.gov.au/documents/1259/RTF/Exposure\\_Draft\\_bill.rtf](http://www.treasury.gov.au/documents/1259/RTF/Exposure_Draft_bill.rtf), accessed 21 May 2007.

<sup>98</sup> <http://www.treasury.gov.au/contentitem.asp?NavId=037&ContentID=1259>, accessed 21 May 2007.

<sup>99</sup> [http://www.treasury.gov.au/documents/1199/PDF/Streamlining\\_prudential\\_regulation.pdf](http://www.treasury.gov.au/documents/1199/PDF/Streamlining_prudential_regulation.pdf), accessed 21 May 2007.

## Finance and Securities Update

### Buy Backs and Listed Managed Investment Scheme

ASIC recently announced that it will review current laws concerning buy backs of interests in listed management investment schemes with a view to developing a policy that will allow these schemes to utilize processes available to listed companies.<sup>100</sup> The size of this financial market and inherent problems has led to a demand for change. Currently there are more than 180 managed investments listed on the ASX.<sup>101</sup>

In a recent address, Mr Jeffrey Lucy AM, Chairman of ASIC said:

The size of our investment funds pool is US\$700 billion, the largest in Asia and fourth largest in the world. Our per capita average of investment in managed funds is valued at close to AU \$50, 000, dwarfing all other nations (including the United States by 20%) and reflecting an increase of around 115% over the last five years.<sup>102</sup>

The current laws concerning buy backs of interests in managed investments are found in Ch 5C of the Corporations Act. Managed Investments are defined in section 9 of the Corporations Act;<sup>103</sup> and chapter 5C regulates the operation of those Managed investment schemes that are required to be registered with ASIC.<sup>104</sup>

#### History

The issue of buybacks is not a recent one; prior to the introduction of chapter 5C into the Corporations Act

100 ASIC media and Information release IR 06-30 5th September 2006.  
101 <http://www.asx.com.au> accessed 13/02/07- the combined assets \$207Billion.

102 Global markets: Regulating for economic growth. The opening address given at the ASIC Summer School 5th 2007 Sydney.

103 The key components are

(i) people contribute money or money's worth as consideration to acquire rights ( interests ) to benefits produced by the scheme (whether the rights are actual, prospective or contingent and whether they are enforceable or not);

(ii) any of the contributions are to be pooled, or used in a common enterprise, to produce financial benefits, or benefits consisting of rights or interests in property, for the people (the members ) who hold interests in the scheme (whether as contributors to the scheme or as people who have acquired interests from holders);

(iii) the members do not have day-to-day control over the operation of the scheme (whether or not they have the right to be consulted or to give directions); or

(b) a time-sharing scheme;

...

104 s. 601ED sets out the circumstances in which a scheme has to be registered. The key requirements are:

more than 20 members; or it was promoted by a person, , who was, when the scheme was promoted, in the business of promoting managed investment schemes.

ations Act in 1998 some public unit trusts were governed by chapter 7.12 of the Corporations Law<sup>105</sup>. These forms of investment schemes were fraught with problems not least of which was the issue of withdrawal of investors' interests from the scheme.

The collapse of the Estate Mortgage trusts in particular focused attention on the difficulties facing unlisted property trusts. Within a year asset values had fallen by almost \$2 billion (or 22%) to \$6.9 billion, resulting in quite spectacular capital losses by investors in these property trusts and triggering the virtual closure of all unlisted property trusts except those whose management companies were controlled by banks. The opportunity for the remaining unlisted property trusts to increase their market share was short-lived, however. The loss of confidence by investors meant that redemption requests continued to outstrip applications for new units.<sup>106</sup>

#### Current problems

Members of a registered managed investment scheme do not have an automatic right to 'withdraw' from the scheme. If this right is to exist it must be written into the constitution, however this does not prevent the investor transferring their interest to another party. If the MIS is listed on the ASX then the units are sold at market price to other investors.

If members are to have a right to withdraw from the scheme, the scheme's constitution must:

a) specify the right<sup>107</sup>

#### Liquidity and s.601GA(4)

Part of the problem faced by managed investment schemes in relation to buybacks is found in s.610GA (4). This section requires that if the constitution gives the member the right to withdraw from the scheme then it must set out 'adequate procedures' for dealing with this right.<sup>108</sup>

105 These schemes were referred to as prescribed interests.

106 Collective Investments: Other Peoples money CAMAC Sept.1993. Para 1.5. PS 77 also refers to the problems associated particularly with unlisted property trusts during that period.

Collective Investments: Other Peoples money.

107 s.601GA(4)

108 The phrase 'adequate provisions' is discussed in PS 134 Managed Investment Schemes: Constitutions. This Policy Statement states that

(4) If members are to have a right to withdraw from the scheme, the scheme's constitution must:

- (a) .....
- (b) if the right may be exercised while the scheme is liquid (as defined in section 601KA) set out adequate procedures for making and dealing with withdrawal requests; and
- (c) if the right may be exercised while the scheme is not liquid (as defined in section 601KA) provide for the right to be exercised in accordance with Part 5C.6 and set out any other adequate procedures (consistent with that Part) that are to apply to making and dealing with withdrawal requests.

The right to withdraw and any provisions in the constitution setting out procedures for making and dealing with withdrawal requests, must be fair to all members.<sup>109</sup>

Therefore the definition of liquid and non liquid is critical in the procedures leading to a withdrawal of members interests in managed investment schemes. S.601KA (4) defines a liquid scheme and s.601KA(5) defines liquid assets:

(4) A registered scheme is liquid if liquid assets account for at least 80% of the value of scheme property.

(5) The following are liquid assets unless it is proved that the responsible entity cannot reasonably be expected to realise them within the time specified in the constitution for satisfying withdrawal requests while the scheme is liquid:

- (a) money in an account or on deposit with a bank;
- (b) bank accepted bills;
- (c) marketable securities (as defined in section 9);
- (d) property of a prescribed kind.

(6) Any other property is a liquid asset if the responsible entity

Reasonably expects that the property can be realised for its market value within the period specified in the constitution for satisfying withdrawal requests while the scheme is liquid.<sup>110</sup>

This definition of 'liquid' is likely to exclude property and infrastructure managed investments which are therefore classed as non liquid and must comply with the provisions of chapter 5C relating to buybacks in non liquid schemes. In these circumstances all members are required to be given notice of a withdrawal offer which must remain open for 21 days. This contrasts with on market share trades.

the phrase means that one must be able to objectively test the determination of the issue price and the withdrawal amount from the terms of the constitution.' We consider that adequate provision has been made when a constitution provides for an independently verifiable price.' PS 134.19

If there is provision for withdrawal, the constitution must include a method for calculating the exit price in a way which is fair to all members and independently verifiable. Fairness will normally require that the price depend on appropriate, and reasonably current, valuations of scheme property. PS 134.25

109 S.601GA(4)  
110 S.601KA(4)(5)

## Policy Statement 134

Policy Statement 134 focuses on the constitutions of managed investment schemes, and 134.25 deals with withdrawal rights of members, it states that the constitution complies with s.601GA (4) if it sets out 'fair' provisions about how a member can withdraw and the method of calculating the exit price is fair to all and independently verifiable.<sup>111</sup> A responsible entity is generally regarded as not complying with chapter 5C if it has discretion in relation to the price for the acquisition of an interest or withdrawal from the scheme.

## Class orders

The problem associated with buybacks of interests in managed investment schemes is not a new one<sup>112</sup>, class orders in recent years indicate that there is concern about the inflexibility of the current legislation and its interpretation<sup>113</sup>. Class Order 05/1236<sup>114</sup> provides that the constitution may give the responsible entity some discretion in calculating the consideration for acquiring interests or members withdrawing from schemes, thus moving from the idea that the consideration must be 'independently verifiable'. There are a number of conditions to the use of this discretion however the key is that the responsible entity 'must act reasonably in the exercise of this discretion'<sup>115</sup>The class order explains that the discretion, when exercised must be consistent with ordinary commercial practice for valuing property and consistent with ordinary commercial practice for working out the market price for interests of the same kind.<sup>116</sup> Furthermore there must be documentary evidence of the exercise of this discretion<sup>117</sup>. The impact of this class order is that the responsible entity will now have some discretion when calculating entry and withdrawal costs.

The attachment to the information release accompanying this order commented that it was unlikely that the class order would apply to listed managed investments as the interests are bought and sold at market price, however if the responsible entity has any discretion then the class order would apply.

111 Managed Investments: Constitutions, issued 3/8/1998 most recently updated 11/9/2000.

13 IR 05-34 ASIC extends interim relief for certain managed investment scheme constitutions to give the responsible entity discretion to determine parts of the redemption price of interests in managed investment schemes.

113 S.601QA(1) allows ASIC to use its statutory powers to modify and/or grant exemptions from the Act

114 CO 06/1236 varies CO 05/26.

115 601GAC(4)

116 601GAC (5)

117 601 GAC(6)

## Consultation paper

In announcing plans to develop a policy on buy backs from listed managed investment schemes a statement released from ASIC said that the policy will take into account industry concerns that existing regulation of buyback offers make it difficult for listed schemes to use the capital management techniques available to listed companies because of the requirements of chapter 5C. The statement also notes that the final policy must balance two main factors ‘...maintaining the special protections the law provides for holders of interests in managed investment schemes and the needs for funds competing in an increasingly global market to have some of the capital management techniques available to listed companies’<sup>118</sup>

In December 2006 ASIC released IR 06-44, this document announced that ASIC had issued a consultation paper in relation to a proposed policy about buy backs in listed managed investment schemes. The information release quotes ASIC’s Executive Director of Regulation, Mr Malcolm Rodgers as saying that ‘... ASIC is seeking to enable ASX listed schemes to use a cost effective transparent and fair means of returning capital to its members, without disadvantaging other members of the schemes’

The ASIC consultation paper *On-market buy-backs by ASX listed schemes*<sup>119</sup> sets out proposed policies for on market buy backs of interests, and following the consultation period a final policy will be issued. This paper makes it clear that the policy will only apply to buy-backs occurring in the ordinary course of trading on the ASX.<sup>120</sup>

The paper says that it will consider two main factors when developing its policy, the protection of the members particularly in relation to withdrawals whilst balancing the needs of the schemes to use a ‘range of capital management techniques to serve the best interests of its members’ and also to consider the rights of creditors of the responsible entity.<sup>121</sup>

The consultation paper identifies property and infrastructure trusts as those most likely to be non

liquid because of the nature of the assets held and therefore be unable to engage in the traditional trading on the ASX. However the consultation paper proposes to give relief to all listed non liquid schemes so they may participate in on market buy backs.<sup>122</sup>

The consultation paper comprises of 8 sections; each dealing with different issues and problems associated with buy backs.

### Section 1

Section 1 identifies the key legal areas currently posing problems, specifically s.601GA(4) which requires that the constitution contain adequate provisions in the constitution for calculating the withdrawal price; the current withdrawal provisions contained in Part 5.6 for non liquid schemes and takeover rules. This section makes it clear that the proposed relief that will be given when the new policy is implemented will only be for buy backs carried on in the normal course of business on the ASX.

### Section 2

Section 2 examines withdrawals (buy backs) under Part 5C.6, this part in the Corporations Act sets out the procedures for withdrawal from non liquid schemes. The first point to be made in this section is that Part 5C.6 is inconsistent with ASX market rules. The lead time of 21 days in relation to non liquid schemes is inconsistent with the continuous nature of on market buy backs, and result in listed property or infrastructure trusts being unable to engaging in on market buy backs.

### Section 3

Section 3 of the Consultation paper discusses the buy-back price and proposes to allow responsible entities to use their discretion (within certain limits) to set the buy back price and also to require the constitution to contain a formula or method of determining the buy back price.

It is noted in section 3 that the buyback price would be expected to change in line with the prevailing market prices quoted on the ASX. This would seem to work against the requirements of s.601GA, however this issue could be dealt with by making the buy back price specifically referable to the market price and thus comply with the requirements of s.601GA(4) that the price be independently verifiable.<sup>123</sup> If the responsible entity places buy orders above the prevailing market price it would be exercising its discretion and the

118 IR 06-30 5 September 2006

119 Issued December 2006

120 Section 1 1.2

121 The rights of creditors has been at the fore front of many discussions of managed investments. The Companies and Securities Advisory Committee Report to the Minister for Financial Services and Regulation: Liability of Members of Managed Investment Schemes March 2000 stated “Any right of members to withdraw from a scheme under a withdrawal offer should be made subject to a requirement that it “does not materially prejudice” the ability of the responsible entity to pay the existing scheme creditors from the remaining scheme assets for any debts for which scheme creditors have rights against scheme assets.”

122 Section 2 of the consultation paper .  
123 3.6

price would not be independently verifiable and therefore it must ensure that it is acting in the best interests of its members.

Section 3.11 proposes that the ASXLR price ceiling be utilized rather than the net asset backing price, on the basis that the price set can be relied upon as a measure of value.

#### **Section 4**

Section 4 is titled 'Buy-back approval' and commences with the statement that on market buy backs that fall within the '10/12' limit will not require member approval.<sup>124</sup> Where the buy-back exceeds 10/12' then member approval is required.<sup>125</sup> The bigger the size of the buy back the greater the risk of the responsible entity having increased control and also the greater amount of scheme property required to fund the buyback. Buy-backs over the '10/12' limit are therefore more likely to give rise to control issues.

This section also discusses the costs involved in calling members meetings and suggests that in circumstances where the scheme is 'stapled' to a company the buy back could be debated at the AGM. In relation to the other circumstances the Paper asks for feedback on the costs associated in convening a meeting to obtain scheme member approval. Section 4 then moves on to discuss voter restrictions at these meetings and decides that existing sections of the Corporations Act are adequate<sup>126</sup> and that information supplied to the member should be all the information known to the responsible entity that is material to the decision of how to vote on the resolution. Section 4.10 sets out minimum disclosures to members; this replicates PS 110.45<sup>127</sup> which states that shareholders voting on a buy-back resolution or receiving offers must be sent all information which is material to their decision. The policy statement is not prescriptive however it does set out the minimum information that should be provided to shareholders.

If the market buy back is below the '10/12' limit the paper suggests that members are given some opportunity to participate. It is proposed that this occur through the utilization of the existing market notices under the ASXLR, the information that must be included is the interests of the responsible entity and associates who may participate in the buy back and the sources of funds for the

buyback. Furthermore the buyback must not commence until after 21 days of the posting of the notice.

#### **Section 5**

Section 5 focuses on buybacks in the ordinary course of trading. The proposal from this section is that the facilitation of on market buybacks by ASX listed schemes be limited to buybacks in the ordinary course of trading on the ASX.<sup>128</sup> The remainder of this section of the consultation paper discusses whether transactions involving 'crossings' should also be included in the relief to be granted in the forthcoming policy.<sup>129</sup> 'Special crossings' are not permitted for on market buy backs and section 5.5 notes that priority crossings are not expressly mentioned in the ASX market rules. Section 5.9 concludes that any on market buy back carried out partially or completely by a priority crossing would contravene the equal treatment rule and therefore relief is not required in the case of these types of crossings.

#### **Section 6**

Section 6 contains a brief discussion of the issue of takeovers and buybacks. It recognizes that there may be control issues when an on market buy back exceeds the 10/12 limit and could result in 'entrenching' the responsible entity control if it and its associates do not sell into the buyback. However the member approval as discussed in section 4 will apply in these circumstances and therefore members will be aware of these facts.

#### **Section 7**

Section 7 deals with the lodgment of notices with ASIC. It proposes that the responsible entity of a listed managed investment scheme will not have to give a separate notice to ASIC of an on market buy back as the ASX will pass on this information to ASIC. However the responsible entity of a non liquid scheme will need to notify ASIC of any withdrawal offers made under part 5.6. This will be necessary to ensure that there is compliance with that Part.

#### **Section 8**

Section 8 considers the position of the creditor in relation to buy backs. This section proposes that the responsible entity must be satisfied that scheme creditors will not be materially prejudiced by the buy back.<sup>130</sup>

<sup>124</sup> 10% of the smallest number during the last 12 months of votes attached to voting shares.

<sup>125</sup> section 4.1

<sup>126</sup> s.253E

<sup>127</sup> PS 145. Share buy backs.

<sup>128</sup> section 5.1

<sup>129</sup> Crossings refer to transactions where the broker acts for both sides. See ASX website for further discussion.

<sup>130</sup> Liability of Members of Managed Investment Schemes March 2000, n.22.

Comments on the proposed policy are due by March 12<sup>th</sup>; hopefully the final document will provide some certainty for the members and responsible entities in what is a somewhat confused area. The biggest danger is still the problem associated with non liquid schemes, particularly property trusts where the value of property can move sharply and quickly and within the 21 day period.

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## Intellectual Property Law Update

# Whistleblowing, Confidentiality and the McCabe Case

### The McCabe Case

Rolah McCabe, in 2002, was the first person in Australia to successfully sue a large tobacco company for cancer related damages. The Victorian Supreme Court ordered that British American Tobacco (BAT) pay her \$700 000, however the decision was overturned by the Court of Appeal.<sup>131</sup>

The damages were awarded by the trial judge, not because the plaintiff was able to prove the allegations made against BAT, but because BAT's defence was found to have been carried out improperly. The destruction of documents potentially relevant to the action by defence lawyers, Clayton Utz was held by the trial judge to be unlawful, the defence was therefore struck out and Mrs McCabe's claim was upheld without challenge.

The Court of Appeal disagreed with the reasons of the trial judge. They held that the destruction of potentially relevant documents by the defendants was part of a legitimate document management policy and did not sufficiently prejudice the trial to warrant striking out the whole defence. A retrial was ordered.

Between the trial and the appeal, Clayton Utz internally investigated the claim that two of its employees had acted improperly and tabled a report. In October last year, a former Clayton Utz employee, Chris Dale, released the findings of the internal report to the media. Due to the seriousness of the professional misconduct alleged in the report, the matter was referred to the Legal Services Commission and the DPP. McCabe's lawyers, Slater and Gordon, are now seeking to reopen her case against BAT based on the information contained in the report.

BAT's reaction to the public disclosure of the report has been as follows:

Since the internal inquiry was disclosed, British American Tobacco has launched legal actions aimed at keeping parts of it confidential. Law firm Slater and

Gordon, which represented Mrs McCabe, is fighting an injunction issued by BAT, while The Sunday Age and The Australian Financial Review recently agreed to settle with the tobacco company. BAT has sent letters to the Victorian Cancer Council and the McCabe family warning them not to speak about certain parts of the internal report.<sup>132</sup>

Further, Clayton Utz is threatening to sue Mr Dale for breaching his confidentiality obligations to the firm. It is this potential action which is the subject of the discussion below.

### Whistleblower Protection

There is specific legislation to protect public servant whistleblowers. The Commonwealth, Australian Capital Territory, New South Wales, Queensland, South Australia, Tasmania, Western Australia and Victoria have all enacted whistleblower legislation.<sup>133</sup> In general, the model employed in each piece of legislation is similar. The legislation covers disclosures made by certain persons about public service agencies. These agencies can include, in Queensland and Western Australia, public sector contractors who supply goods and services to a public sector entity. As well, the legislation in the ACT, Queensland, Western Australia and in South Australia allows disclosure about activities which create a specific danger to the health and safety of the public.<sup>134</sup>

In some cases, it is only public sector employees who may disclose information, however, the Australian Capital Territory, South Australia, Victoria and Western Australia legislation allows any person to disclose the information to a person or persons in authority.<sup>135</sup>

At this stage, however, very little legislation protects private sector whistleblowers unless their employer is involved in undertaking public sector contracts and outsourcing or involved in activities which create a specific danger to the health and

<sup>132</sup> Nick McKenzie, 'Hulls Acts over McCabe case', *The Age*, 21 December 2006.

<sup>133</sup> *Public Interest Disclosure Act 2001 (Cth)*; *Public Interest Disclosure Act 1994 (ACT)*; *Protected Disclosures Act 1994 (NSW)*; *Whistleblowers Protection Act 1994 (Qld)*; *Whistleblowers Protection Act 1993 (SA)*; *Whistleblowers Protection Act 2001 (Vic)*; *Public Interest Disclosure Act 2003 (WA)*; *Public Interest Disclosures Act 2002 (Tas)*. The Northern Territory introduced a *Public Interest Disclosure Bill* in 2005 but it has not progressed.

<sup>134</sup> M Jackson, *A Practical Guide to the Protection of Confidential Business Information*, LawBook Co, 2003, para 7.45.

<sup>135</sup> *Ibid*.

<sup>131</sup> See *McCabe v British American Tobacco Australia Services Ltd* [2002] VSC 73; *British American Tobacco Australia Services Ltd v Cowell* [2002] VSCA 197.

safety of the public. Those organisations which do work for the public sector in particular should not assume that the legislation is limited only to government departments and should be aware of the operation of the relevant legislation.<sup>136</sup>

The *General Insurance Act 2001* (Cth) was the first legislation to contain a protection for whistleblowers. Sections 49A-49D provide specific protection to current or former general insurance auditors and actuaries who provide information about an insurance company to the Australian Prudential Regulation Authority.<sup>137</sup> Whistleblower legislation applicable to the private sector relates to company auditors and members of external audit teams under Part 9.4AAA of the *Corporations Act 2001* (Cth) if they receive information from a whistleblower.<sup>138</sup>

The whistleblower protection under the Act operates in the same way as the public sector legislation. The disclosure must be made to particular persons specified in the legislation, for example, ASIC, the company's auditor, a member of the audit team, a senior manager of the company, or another person authorised by the company to receive revelations of this kind. The media is not a person or organisation to whom information should be disclosed. Persons making the disclosure are immune from civil and criminal liability, as well as immunity from action for the contravention of confidentiality obligations.

It would appear then, that Mr Dale is not able to rely on any legislative protection here for whistleblowers and, even if he could, the fact that he disclosed the confidential report to the media would have reduced his chances of such reliance.

### Confidentiality

The equitable obligation of confidence may arise explicitly or implicitly as a result of a contractual relationship such as an employment contract, or implicitly as a result of a fiduciary relationship. It is extremely likely that Clayton Utz would have had a confidentiality clause in its partnership agreement to the effect that a partner must not use, communicate or keep a record of the firm's sensitive information which is either confidential or provides the firm with a competitive advantage. Generally an employer will succeed against an ex-employee if it can be shown that the ex-employee has acted unfairly or dishonestly in dealing with

confidential information which was acquired during his or her employment. Even if the alleged breach of confidentiality occurred subsequent to employment, the employer may take action for breach of confidence.<sup>139</sup>

In the present situation, it is probable therefore that Mr Dale has a prima facie obligation of confidentiality to Clayton Utz in relation to the internal report and that by releasing the report to the media, this obligation has been breached. This being the case, the question then is, what defences are available to Mr Dale against a claimed breach of confidentiality?

One possible defence to an action for breach of confidentiality is the 'public interest' defence. However, it is by no means a clear and settled defence in Australian law. The defence would require that the public interest in disclosure outweighs the public interest in maintaining the confidence.<sup>140</sup> Kirby J has approved such a defence,<sup>141</sup> however, both Gummow J<sup>142</sup> and Grey J<sup>143</sup> have rejected the approach. It is therefore doubtful that the public interest defence would be accepted by an Australian court.

The other common law defence to a breach of confidentiality is the 'iniquity' defence. This is also a very limited defence and applies only in situations where the confidential information disclosed reveals serious wrongdoing by the person relying on the obligation of confidence. It will be made out if it can be established that:<sup>144</sup>

- (a) The proposed disclosure will in fact disclose the existence of, or the real likelihood of the existence of an iniquity that is a crime, civil wrong or serious misdeed of public importance;<sup>145</sup>
- (b) The iniquity to be disclosed is of a character of public importance, in the sense that what is to be disclosed affects the community as a whole, or affects the public welfare; and
- (c) The person who is seeking to protect the confidence is so doing in order to prevent disclosure to a third party with a real and direct

<sup>136</sup> Ibid, para 7.46.

<sup>137</sup> Ibid.

<sup>138</sup> See the ASIC website for more information on Part 9.4AAA at <http://www.asic.gov.au/asic/asic.nsf/byheadline/Whistleblowers:+Company+auditors+obligations?openDocument>, accessed 25 March 2007.

<sup>139</sup> M. Jackson, op cit [5.15]-[5.20]

<sup>140</sup> *Woodward v Hutchens* [1977] 1 WLR 760 at 764

<sup>141</sup> *AG (UK) v Heinemann Publishers Pty Ltd* (1987) 10 NSWLR 86

<sup>142</sup> *Corrs Pavey Whiting and Byrne v Collector of Customs* (1987) 14 FCR 434; *Smith Kline and French Laboratories (Australia) Ltd v Secretary Department of Community Services and Health* (1990) 22 FLR 73

<sup>143</sup> *Sullivan v Sclanders* (2000) 77 SASR 419

<sup>144</sup> *AFL v The Age Ltd* [2006] VSC 308

<sup>145</sup> *AG Australia Holdings Ltd v Burton and Anor* (2002) NSWLR 464 at 523

interest in redressing the alleged crime, wrong or misdeed.<sup>146</sup>

Given the nature of the internal report, which apparently discloses that Clayton Utz employees advised BAT that it could continue its document management policy, and given that it was found both in *US v Phillip Morris*<sup>147</sup> and *Re Mowbray*<sup>148</sup> that BAT had, as part of that policy, intentionally destroyed documents relevant to those actions, it seems quite possible that Mr Dale will be able to establish all three limbs of the iniquity defence.

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<sup>146</sup> *Corrs Pavey Whiting and Byrne v Collector of Customs* (1987) 14 FLR 434 at 456

<sup>147</sup> US District Court for Columbia, Civil Action No 99-2496, July 21, 2004.

<sup>148</sup> (Re Mowbray) *Brambles Australia Ltd v British American Tobacco Australia Services Ltd* [2006] NSWDDT 15.

## Taxation Update

# Simplified Superannuation: A Briefing

### Introduction

Superannuation is big business and according to the Australian Prudential Regulation Authority (APRA), as at September 2006, there was \$945.6 billion of assets held within superannuation funds.<sup>149</sup> The Australian Taxation Office has announced that as at 31 December 2006 there were 331,576 self-managed superannuation funds (SMSF) having assets of \$234 billion.<sup>150</sup> Given the proposed new law relating to superannuation and the ability to make an undeducted contribution of \$1 million before 30 June 2007, the prediction is that there will be more than \$1 trillion of superannuation assets and more than \$250 billion held within SMSF's. This means that the new simplified superannuation rules have significant implications for those taxpayers contemplating retirement from work and especially if they are over, or close to 60 years of age. However, have the new laws simplified superannuation or are there additional complications?

The new law to simplify superannuation was contained in the Tax Laws Amendment (Simplified Superannuation) Bill 2006. The Bill received Royal Assent on 15 March and is now law. The major reforms in the new law will take effect from 1 July 2007. The Bill was subject to change in the Senate and the Senate Economics Committee made 8 recommendations, and some of those recommendations were included in the Bills introduced on the 7 February 2007.<sup>151</sup>

The Government estimated that the financial impact on revenue of the changes to the law to amount to \$7.2 billion over the next 4 years.

2006-2007	2007-2008	2008-2009	2009-2010
\$0.1 billion	\$2.2 billion	\$2.3 billion	\$2.6 billion

<sup>149</sup> Australian Prudential Regulation Authority, Statistics Quarterly Superannuation Performance, September 2006 accessed 21 March 2007 <www.apra.gov.au>

<sup>150</sup> Australian Taxation Office

<sup>151</sup> Source: Senate Economics Committee's report, Tax Laws Amendment (Simplified Superannuation) Bill 2006 and related bills, 7 February 2007; Shadow Minister for Superannuation media release, 7 February 2007

It is quite possible that the above amounts are over stated due to the fact that the superannuation industry expects a further \$250 billion to be contributed to superannuation funds prior to 1 July 2007 as non-concessional contributions. That is the deadline when the ability to contribute the sum of \$1 million ends. The earnings on this money, even at a return of only 5%, would generate a great deal of income tax even at the concessional rate of 15%. The new measures should encourage taxpayers to stay in the workforce until at least 60 years of age and this fact was not lost on the Government. This would result in more funds being contributed and more income tax being levied at 15%.<sup>152</sup>

### Outline of the New Superannuation Law

It is important to note that the Government changed the terminology of contributions to superannuation funds. Deductible contributions are now referred to as 'concessional' contributions and non-deductible contributions as 'non-concessional' contributions.

The simplification of superannuation means that the following features will apply to Australian members of superannuation funds from 1 July 2007:

1. A member over 60 years of age, from 1 July 2007, will not be taxed on the receipt of benefits from a taxed fund, whether the benefit is paid in the form of a pension or a lump sum. If a member retires before they turn 60 years of age then the benefits are subject to the same taxation treatment that applied before 1 July 2007.
2. Reasonable Benefit Limits (RBL's) are abolished. In its place will be a restriction on the amount of money that can be contributed both as a deductible or concessional basis and a non-deductible or non-concessional basis. Any amounts in excess of the above limits are then taxed in the hands of the trustee at the rate of 46.5%.

The Government introduced a transitional rule that \$1m could be contributed as an undeducted or non-concessional contribution prior to 1 July 2007, and thereafter on the following basis.

<sup>152</sup> Explanatory Memorandum, Tax laws Amendment (Simplified Superannuation) Bill 2006, Chapter 8 – Regulation impact statement.

### Contribution Rules

An employee or a self-employed person can have deductible, or concessional contributions made on their behalf or by them, if less than 55 years of age, of \$50,000 per annum, indexed. If the employee or self-employed person is over 55 years then the concessional contribution can be \$100,000 for the next 5 years, ending 30 June 2012. These limits are designed to bring about equality among retired taxpayers in place of the 'Reasonable Benefit Limits', RBL's. A member of a superannuation fund was able to make an undeducted or non-concessional contribution of \$1 million only until 30 June 2007. However, prior to this rule being introduced, members of funds could make unrestricted undeducted contributions to the fund. After 1 July 2007, the amount of money that can be contributed as a non-concessional contribution then drops to \$150,000 per member or \$450,000 over 3 years. If a member makes a contribution of \$450,000, then they cannot make a further non-concessional contribution for a period of 3 years. Reasonable benefit limits will be abolished for benefits received from 1 July 2007.

### Employer Termination Payments

The former ETP's, eligible termination payments, are, as from 1 July 2007, referred to as 'employment termination payments'. The other substantial change to the taxation treatment of ETP's is that they must be taken in cash and not rolled into a superannuation fund unless transitional rules apply. The pre-June 1983 component of an employer termination payment will still be exempt from income tax, but the concessional amount up to \$140,000 will be subject to income tax at the rate of 15% for those people retiring over the age of 55 years and 30% if under 55 years of age when retiring. Amounts paid in excess of the \$140,000 are subject to income tax at the highest marginal rate, namely 46.5%, (45% + 1.5% Medicare levy) the same rate that applies to contributions to a superannuation fund in excess of the contribution limits.

### Benefits for Taxpayers

The new simplified superannuation rules allow an employee up to 75 years of age to have deductible contributions made on their behalf by their employer, provided they satisfy the work test. In order to satisfy the work test, the employee must be engaged in 30 hours of paid work in 40 days. Self-employed are now able to claim a full deduction for concessional contributions made and not the first \$5,000 plus 75% of balance up to age

based limit. If a member obtains superannuation benefits from a source that is not taxed (such as public service super funds), the benefits will continue to be taxed when they receive them. However, they may be entitled to a tax offset that will reduce the tax payable on those benefits.

The following table explains the effect of the new law to simplify the taxation of superannuation.

Age of Taxpayer	Taxation of Contributions	Taxation of Earnings	Taxation of Benefits
Before 60 years of age	Taxable at 15%	Taxable at 15% except for capital gains with 33% discount	Taxable but with rebates
Over 60 years of age	Taxable at 15%	Taxable at 15% except for capital gains with 33% discount	Tax Free (non-assessable and non-exempt income)

The OECD member countries generally have adopted the approach of having contributions and earnings exempt from taxation and the retirement benefits subject to income tax in the hands of the retired beneficiary. In this way the amount of money available on retirement has had an opportunity to grow before it is subsequently reduced by the effect of taxation. In Australia, the Government imposes income tax on both the tax deductible contributions and the earnings of the fund but at the concessional flat rate of 15%, with a 33.3% discount on capital gains.

### Criticism of the New Law

Has the new law simplified superannuation in Australia? For those members over 60 years of age, the new law has simplified superannuation. However, for those members under 55 years of age virtually nothing has changed because the Government would like to encourage employees to remain in the workforce until at least aged 60 years or over. The other area that has resulted in some level of hardship for those people retiring is with 'Employer Termination Payments'. The fact that they can no longer be rolled into a superannuation fund will result in more income tax being paid by the recipients of ETP's, especially for amounts in excess of \$140,000.

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## Article

# Authorisation of Copyright Infringement: New Developments in the Online Environment

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## Abstract

*The introduction of peer-to-peer file sharing software (P2P) has led to the growth in unauthorised content downloading of, in particular, music files. Copyright owners claim that the providers of this software are 'authorising' others to infringe copyright and have taken legal action against these providers, rather than against the direct copyright infringers. The providers claim they have no control over what users do with the P2P software. This article explores the issue of authorisation of copyright infringement by discussing the relevant law and examining recent cases in Australia and the United States. It explores the extent to which manufacturers or providers of technology that can be used to infringe copyright need to act to stop or reduce the infringement as a result of recent court decisions.*

## Introduction

The word 'authorize', in legislation of similar intentment to s 36 of the Act, has been held judicially to have its dictionary meaning of 'sanction, approve, countenance...'.<sup>153</sup>

New technological developments over a number of centuries have made it easier for copyright material to be copied but the 21<sup>st</sup> century in particular has seen the introduction of technology which has allowed users themselves to copy material. The duplicating machine, the photocopier, the video recorder and the computer have all granted users the ability to copy material owned by others, frequently without permission to make such copies. Given the difficulty in locating the many users who might be copying material in libraries, schools, at work or in their homes, copyright owners have often sought injunctions against the manufacturers or providers of the technology used for unauthorised copying. In

Australia in 1973, for example, one of the first of such cases involved action by a publisher against the provider of a photocopier in a university library.<sup>154</sup> In the United States, the seminal *Sony* case began in 1976 when Universal Studios and others sought an injunction against the manufacturer of a video tape recorder, rather than attempting to pursue infringing individuals.<sup>155</sup>

The combination of the internet and the P2P file sharing environment has led to changes in the way consumers access, listen to and share music and films, and to the ways some artists disseminate their music and videos.<sup>156</sup> It has also exposed the personal use activities of individuals in respect of copyrighted works.

Recent cases, both in Australia and the United States, as well as other countries, have concerned action by the music industry against the providers of file sharing software (referred to as peer-to-peer or P2P software).<sup>157</sup> The plaintiffs have alleged that the providers of such software have authorised others, the users of the software, to infringe copyright. The providers have argued that it is the choice of the acquirers of the software how they use it. P2P software can be used for both infringing and non-infringing uses.

154 *UNSW v Moorhouse and Angus & Robertson (Publishers) Pty Ltd (1975) 133 CLR 1.*

155 *Sony Corporation of America et al v Universal Studios, Inc, et al 464 US 417, (1984) (Sony case).*

156 M Naphthali, 'Unauthorised: Some Thoughts upon the doctrine of authorisation of copyright infringement in the peer to peer age' (2005) 16 *Australian Intellectual Property Journal* 5, 7.

157 See, eg, *A&M Records, Inc v Napster Inc*, 114 Supp 2d 896 CND Cal 2000; *A&M Records, Inc v Napster Inc*, 239 F3d 1004 (9th Cir 2001); *Sony Music Entertainment (UK) Ltd and others v Easyinternetcafe Ltd* [2003] EWHC 62 (Ch); *Vereniging Buma, Stichting Stemra v Kazaa BV*, Supreme Court of the Netherlands (Hoge Raad), decision of 19 December 2003, AN7253 Case No: C02/186HR; *Metro-Goldwyn-Mayer Studios, Inc, and Others v Grokster Ltd, and Others*, 380 F. 3rd 1154 (9th Cir 2004); *BMG Canada Inc v John Doe* [2004] FC 488; *Metro-Goldwyn-Mayer Studios inc. et al.*, *Petitioners v Grokster Ltd et al*, 545 U.S. 1 (2005); *Universal Music Australia Pty Ltd v Sharman License Holdings Ltd* (2005) FCA 1242; *BMG Canada Inc v John Doe* [2005] FCA 193; *In Re Aimster Litigation* 334 F 3d 643 (7th Cir 2003); *Cooper v Universal Music Australia Pty Ltd* [2006] FCAFC 187.

153 *UNSW v Moorhouse and Angus & Robertson (Publishers) Pty Ltd (1975) 133 CLR 1, 12 (Gibbs J).*

This article explores the concept of authorisation of copyright infringement and seeks to understand the extent of the duty to restrict unauthorised copying borne by manufacturers and providers of technology capable of being used by others to infringe copyright. It examines, through a review of recent cases dealing with copyright and the Internet, whether this duty has become stricter as the capabilities of such infringing technology have become known.

It focuses on the approaches to the issue of authorisation of copyright adopted in Australia and the United States. The applicable law in these two jurisdictions is similar but not identical but the practical results of the cases discussed below have seen a convergence in the approach in each jurisdiction. The facts in these recent cases, however, have moved away from a situation involving a manufacturer of a product capable of being used for infringement to a situation involving the providers of technology to users for the primary purpose of assisting users to infringe copyright.

## Authorisation of Copyright Infringement

### Australian Law

The *Copyright Act* 1968 (Cth) contains the offence of infringement by doing acts comprised in the copyright, in s 36 in respect of works and in s 101 for subject matter other than works. These sections state that copyright is infringed if a person, without the approval of the copyright owner, does any of the exclusive rights of that owner, including communicating or reproducing it, or authorises the doing of those rights. The doing or the authorisation of the doing must have been in Australia.

One of the most significant cases on authorisation occurred in 1973 in *University of New South Wales v Moorhouse*.<sup>158</sup> The Australian Copyright Council supported a test case against the University of NSW to determine if it had authorised copyright infringement by providing photocopiers to library users.<sup>159</sup> To gain evidence for the proceedings against the University, Paul Brennan photocopied two copies of one chapter or story from two books. It was not disputed that Mr. Brennan had infringed copyright as he did not undertake the copying for research or private study and the copying could

not be considered fair dealing under s 40 of the *Copyright Act*. The issue to be considered by the Court was whether the University authorised the act of Mr. Brennan's infringement of copyright.

The Supreme Court of NSW held that a breach of copyright had been undertaken by Mr Brennan, but that the University did not authorise the photocopying undertaken by Mr. Brennan.<sup>160</sup> On appeal, the High Court disagreed with the trial judge's finding and held that the University had authorised the breach of copyright by Mr Brennan.<sup>161</sup> Gibbs J explained:<sup>162</sup>

A person cannot be said to authorize an infringement unless he has some power to prevent it. Express or formal permission or sanction, or active conduct indicating approval, is not essential to constitute an authorization... However, the word 'authorize' connotes a mental element and it could not be inferred that a person had, by mere inactivity, authorized something to be done if he neither knew nor had reason to suspect that the act might be done.

The University in this case, however, had issued a general invitation to students to use the photocopier without informing them of any qualifications about that use and the need to avoid copyright infringement.

In *Moorhouse*, the issuing of an invitation to use the technology without adequate qualification was considered to overcome any need to show that the provider had knowledge of infringing activity. The University certainly had the power to indicate acceptable uses of the copier. In cases since, as the capabilities of such infringing technology have become known, it appears clear that the extent of knowledge about possible infringing activity is an important factor in proving authorisation and that, in some circumstances, failure to take action might lead to authorisation being inferred.<sup>163</sup>

In 2000, the *Copyright Amendment (Digital Agenda) Act (Cth)* was enacted with the object of providing certainty that the Copyright Act applied to the online environment.<sup>164</sup> Of particular

<sup>160</sup> *Moorhouse and Angus & Robertson (Publishers) Pty Ltd Ors v University of New South Wales* (1974) 23 FLR 112.

<sup>161</sup> *University of New South Wales v Moorhouse and Angus & Robertson (Publishers) Pty Ltd* (1975) 133 CLR 1, 22 (Jacob J).

<sup>162</sup> *Ibid*, 12-3 (Gibbs J).

<sup>163</sup> See, eg, *Nationwide News Pty Ltd v Copyright Agency Limited* (1996) 65 FCR 399, para 370 (Sackville J); *WEA International Inc v Hanimex Corp Ltd* (1987) 17 FCR 274. See, in particular, *Australasian Performing Right Association Ltd v Metro on George Pty Ltd and Others* [2004] ALR 244, which concerned a venue hired out for music performances. The defendant had been advised by APRA that copyright infringement was occurring in the music performances but took no action. Bennett J found that failure to act once specific copyright infringements had been made known constituted authorisation of copyright infringement.

<sup>164</sup> *Cooper v Universal Music Australia Pty Ltd* [2006] FCAFC 187, para 14-15 (Branson J).

<sup>158</sup> *University of New South Wales v Moorhouse and Angus & Robertson (Publishers) Pty Ltd* (1975) 133 CLR 1.

<sup>159</sup> *Ibid*.

relevance was the introduction of ss 101(1A) and 112E into the *Copyright Act*.

Section 101(1A) was introduced into the Act to provide a degree of legislative certainty about the steps that should be taken in order to avoid liability for authorising infringements.<sup>165</sup> The factors within s 101(1A) were included to codify the common law principles that existed<sup>166</sup> and were based on the concept of authorisation developed in *Moorhouse*.<sup>167</sup>

The section states that, when considering an allegation of authorisation under s 102(1A), the courts should take into account a number of matters, including the following:

- (a) the extent (if any) of the person's power to prevent the doing of the act concerned;
- (b) the nature of any relationship existing between the person and the person who did the act concerned;
- (c) whether the person took any other reasonable steps to prevent or avoid the doing of the act, including whether the person complied with any relevant industry codes of practice.

Section 101(1A)(c) was intended to provide additional certainty in relation to third party liability. Compliance with relevant industry codes can be a factor in determining whether a person took reasonable steps to prevent or avoid infringement.<sup>168</sup> The inclusion of 'relevant industry codes of practice' into s 101(1A)(c) allows for the reasonable steps obligation to be expanded out with details specific to particular industries or activities.<sup>169</sup> It has been argued that the perceived failure by relevant industries (such as the Internet industry) to implement a code of practice in the time since the commencement of the *Digital Agenda Act* highlights a need for greater incentives for ISPs and copyright owners to develop such codes of practice, and to ensure that they are sanctioned and adopted by all industry participants.<sup>170</sup>

There has been criticism of s 101(1A). Some commentators have argued that s 101(1A) did not have the effect intended, in that the law on authorisation of copyright was not adequately clarified.<sup>171</sup> It has been suggested that the

introduction of the words 'if any' in sub-para (a) may mean that a person may be found liable for infringement even where he or she may have no power to prevent it, even as a result of a deliberate act.<sup>172</sup> Sub-para (c), with its requirement to determine what reasonable steps were taken to prevent infringing activity could address this concern.<sup>173</sup> Others have been concerned about codifying a decision (*Moorhouse*) which was based on an unsound use of authorities.<sup>174</sup>

Section 112E (and s 39B) addresses the situation of carriage service providers, such as ISPs.<sup>175</sup> Generally, in cases where the defendant merely provides the technology to the public and does not control what the public can do with it, authorisation has not been found by the courts.<sup>176</sup> Section 112E sought to confirm this approach and provides that:

A person (including a carrier or a carriage service provider) who provides facilities for making or facilitating the making of, a communication is not taken to have authorised any infringement of copyright in an audio-visual item merely because another person uses the facilities so provided to do something the right to do which is included in the copyright.

The intent is that ISPs and similar providers should not be considered to have authorised infringement merely because they provide the technology by which it may occur. Section 101(1A) should not apply in such cases unless they are doing more than mere provision.

Again, there has been some criticism that this section has not clarified the positions of ISPs. The inclusion of the word 'merely' in particular has been considered to have the effect of doing little to limit the scope of s 101(1A),<sup>177</sup> particularly as it

(Cth) (2005)

<[http://www.law.unimelb.edu.au/ipria/research/Weatherall\\_SafeHarbour\\_Submission.pdf](http://www.law.unimelb.edu.au/ipria/research/Weatherall_SafeHarbour_Submission.pdf)> at 20 December 2006; Phillips Fox, *Digital Agenda Review: Report and Recommendations* (2004) 11.16 and 16.1 <[http://www.ag.gov.au/www/agd/agd.nsf/Page/Publications\\_PhillipsFoxreportDigitalAgendareview-January2004](http://www.ag.gov.au/www/agd/agd.nsf/Page/Publications_PhillipsFoxreportDigitalAgendareview-January2004)> at 14 March 2006.

172 Jane Ginsburg and Sam Ricketson, 'Inducers and Authorisers: A Comparison of the US Supreme Court's Grokster Decision and the Australian Federal Court's Kazaa Ruling' (2006) Working Papers, No 0698 *Columbia Public Law & Legal Theory*, 13 <<http://lsr.nellco.org/columbia/pllt/papers/0698>> at 30 January 2007; Rebecca Giblin-Chen and Mark Davison 'Kazaa Goes the Way of Grokster? Authorisation of Copyright Infringement via Peer to peer networks in Australia' (2006) 17 *Australian Intellectual Property Journal* 53, 68.

173 Ginsburg and Ricketson, above n 20, 13.

174 See Sydney Birchall, 'A Doctrine Under Pressure: The Need for Rationalisation of the Doctrine of Authorisation of Infringement of Copyright in Australia' (2004) 15 *Australian Intellectual Property Journal* 227, 238.

175 Section 39B covers infringement of copyright in works and s 112E covers infringement of copyright in audio-visual items.

176 See *Sony Case* 464 US 417 (1984); *BMG Canada Inc v John Doe* [2005] FCA 193; *Australasian Performing Rights Association Ltd v Gain* (1990) 18 IPR 663.

177 Birchall, above n 22, 242.

165 Revised Explanatory Memorandum, Copyright Amendment (Digital Agenda) Bill 2000 (Cth) 55.

166 *Ibid*.

167 *Cooper v Universal Music Australia Pty Ltd* [2006] FCAFC 187, para 136 (Kenny J).

168 Above n 13.

169 Australian Film Industry Coalition, *Submission to the Review of the Copyright Amendment (Digital Agenda) Act 2000* (2003) 9.

170 *Ibid*, 11-2.

171 See Kimberlee Weatherall, *Response to Attorney-General's Department Review of Part V Division 2AA of the Copyright Act 1968*

was felt that there were few instances where a service provider is only providing facilities.<sup>178</sup>

Finally, the *Copyright Act* was amended in 2005,<sup>179</sup> as a result of the Australian-United States Free Trade Agreement (AUSFTA), to provide that ISPs can mitigate liability by limiting the remedies available against them for copyright infringement by users or for authorisation of it if they follow certain conditions.<sup>180</sup> The Division does not limit the operation of other sections in the Act, such as s 101(1A) and s 36, which may determine whether authorisation of infringement has occurred<sup>181</sup> but, instead, acts to limit their liability in such cases.<sup>182</sup> One commentator has argued that the new provisions create a new head of liability apart from authorisation 'that conscripts remotely related third parties into the war against piracy on the basis of those parties being placed in...a unique position to prevent piracy'.<sup>183</sup>

The conditions to be satisfied include adoption and implementation of a policy that provides for termination of the accounts of repeat infringers and acting expeditiously to remove offending material once advised that infringing copyright material has been cached or stored on a system.<sup>184</sup> Section 116AH(1) in particular states that the ISP must not be receiving a financial benefit from the infringing activity where they can or have the ability to control that activity if they are storing copyright material on their system or network or if they are referring users to an online location. ISPs are not expected, however, to monitor for infringing activity.<sup>185</sup>

The provisions are modelled on safe harbour provisions in s 512 of the US Digital Millennium Copyright Act 2000 (DMCA).<sup>186</sup> It has been suggested, however, that the protection provided to ISPs by these amendments is less than that in the DMCA.<sup>187</sup> In particular, the Australian provisions will not 'provide statutory immunity [to an ISP] for acts taken in good faith to attempt to

bring itself within a safe harbour', unlike the American provisions.<sup>188</sup>

### The American Approach to Copyright Authorisation

The early cases dealing with copyright authorisation and the Internet were American and they were influenced by the 1984 decision, *Sony Corporation of America et al v Universal Studios, Inc, et al* (the *Sony case*).<sup>189</sup> While the American Copyright Act does not contain a section addressing authorisation of copyright infringement, two similar doctrines have been developed by the courts. The first doctrine, contributory copyright infringement, was described as follows:<sup>190</sup>

One who, with knowledge of the infringing activity, induces, causes or materially contributes to the infringing conduct of another, may be held liable as a 'contributory infringer.

The second doctrine, vicarious copyright liability, derives from employment law and requires the plaintiff to show that the defendant has the 'right and ability to supervise the infringing activity and also has a direct financial interest in such activities'.<sup>191</sup> The link is between the direct infringer and the control the peer to peer network has over the direct infringer as well as the benefits received rather than awareness of the infringing activity.<sup>192</sup>

In 1976, Sony, a manufacturer of home video tape recorders (VTRs), was sued by Universal Studios and Walt Disney Productions because it was alleged that purchasers of video recorders were copying television programs and so breaching copyright.<sup>193</sup> Universal and Disney alleged that because Sony had manufactured a product which could be used by a purchaser to infringe copyright, then Sony had contributed to this infringement and so was also liable. The copyright holders were unsuccessful in the first instance, but, on appeal to the Court of Appeal, Sony was held liable for contributory negligence. Sony appealed to the Supreme Court and was successful.<sup>194</sup>

Stevens J, in the majority judgment, stated:<sup>195</sup>

178 GIBLIN-CHEN and DAVISON, above n 20, 75.

179 *Copyright Act 1968* (Cth) div 2, pt v.

180 *Copyright Act 1968* (Cth) s 116AG; Damien O'Brien and Brian Fitzgerald, *Digital copyright law in a YouTube world* (2006) 5 <<http://eprints.qut.edu.au>> at 12 April 2007.

181 *Copyright Act 1968* (Cth) s 116AA(2).

182 *Copyright Act 1968* (Cth) s 116AA(1).

183 Birchall, above n 22, 244.

184 *Copyright Act 1968* (Cth) s 116AH.

185 *Copyright Act 1968* (Cth) s 116AH(2).

186 See, Jan Charbonneau, 'Protecting the Messenger: Carriage Service Providers' Liability for Third Party Copyright Infringement' (2006) 13(2) *E Law – Murdoch University Electronic Journal of Law* <[https://elaw.murdoch.edu.au/issues/2006/2/elaw\\_ProtectingtheMessengerforCarriageServiceProviders.pdf](https://elaw.murdoch.edu.au/issues/2006/2/elaw_ProtectingtheMessengerforCarriageServiceProviders.pdf)> at 4 April 2007.

187 Weatherall, above n 19, 7.

188 Campbell Thompson, *The Copyright Legislation Amendment Act 2004: A stealth attack on CSPs*, Freehills Communications (2004) 20 December

<[http://www.freehills.com.au/publications/publications\\_1349.asp](http://www.freehills.com.au/publications/publications_1349.asp)> at 11 April 2007.

189 464 US 417 (1984).

190 *Gershwin Publishing Corporation v Columbia Artists Management Inc* 443 F.2d 1159 (2d Cir. 1971) 1162 (Anderson CJ).

191 *Fonovisa, Inc. v. Cherry Auction, Inc.*, 76 F.3d 259 (9th Cir. 1996).

192 Fred von Lohmann, IAAL: *What Peer to Peer Developers Need to Know about Copyright Law*, 2006, 5, <[http://www.eff.org/IP/P2P/p2p\\_copyright\\_wp\\_v5.pdf](http://www.eff.org/IP/P2P/p2p_copyright_wp_v5.pdf)> at 4 June 2007.

193 *Sony Case* 464 US 417 (1984).

194 *Ibid*.

195 *Ibid* 592 (Stevens J).

...the sale of copying equipment, like the sale of other articles of commerce, does not constitute contributory infringement if the product is widely used for legitimate, unobjectionable purposes. Indeed, it need merely be capable of substantial non-infringing uses.

Sony had no direct involvement with VTR purchasers and so argued it was not involved in a possible infringing use of the product. Although its advertising material made no mention of copyright law, Sony's VTR instruction manual warned purchasers that unauthorised copying of television programs and content could be a breach of the copyright law. The court assumed that Sony had 'constructive' knowledge that its machines could be used to record copyright material but this fact alone was insufficient for it to be liable as a contributory infringement of copyright.<sup>196</sup> If a product had the capacity for substantial or commercially significant non-infringing uses, then constructive knowledge about possible copyright infringement was not enough and actual or reasonable knowledge that infringing activities were occurring must be shown.

Also, the District Court had found that the unauthorised home taping was a fair use of copyright work,<sup>197</sup> resulting in no reduction in the market for the original work.<sup>198</sup>

The *Sony* decision was revisited in the 2000 case, *A & M Records, Inc v Napster Inc*.<sup>199</sup> Napster software was created in 1999 to assist college students to locate music files which had been compressed using the MP3 format<sup>200</sup> and was a precursor to the peer-to-peer file sharing networks in use now. It operated as a central service which kept a list of the location of shared music files made available by users of the service. The central server did not hold any of the music files; they remained on the individual user's computers.<sup>201</sup> Napster's software, which permitted the file sharing, was provided free to users.

In 2000, representatives of a number of recording studios took action against Napster, claiming it

196 Ibid 582.

197 Ibid 582.

198 It should be noted that, in Australia, unauthorised home taping is not covered by the fair use exemptions in the *Copyright Act*. However, in December 2006, the *Copyright Amendment Act 2006*, Schedule 6, granted, inter alia, individuals the personal use right of limited home taping of broadcasts in some circumstances.

199 114 F Supp 2d 896 CND Cal 2000; *A & M Records, Inc v Napster, Inc* 239 F 3d 1004 (9th Cir 2001).

200 Nicolas Blackmore, 'Peer-to-Peer File Sharing Networks – the Legal and Technological Challenges for Copyright Owners', (2004) 55 *NSW Society for Computers and the Law Journal* <<http://www.nswscl.org.au/journal/55/Blackmore.html>> at 11 March 2005.

201 Ibid 3.

was aiding users to infringe copyright.<sup>202</sup> The District Court accepted that Napster users were engaged in direct copyright infringement<sup>203</sup> and rejected that this infringement was 'fair use' under 17 U.S.C. s 107.<sup>204</sup> The District Court then had to consider whether Napster was secondarily liable for the direct infringement under either contributory copyright infringement and/or vicarious copyright infringement.<sup>205</sup> In considering the first area, the Court debated whether Napster was encouraging or assisting the users to infringe copyright and found that such a case could be shown. Napster had both actual and constructive knowledge of the infringements, unlike Sony which only had constructive knowledge that their customers might use the VTRs to make unauthorised copies of television shows. The fact that Napster could not distinguish between infringing and non-infringing files was not a defence.<sup>206</sup>

The Court found that, following the *Sony* decision, contributory liability could not be proven if a manufacturer or technology provider was 'merely supplying the means to accomplish an infringing activity' and that the software was capable of commercially significant non infringing use.<sup>207</sup> Beezer J of the Appeal Court stated that 'the mere existence of the Napster system, absent actual notice and Napster's demonstrated failure to remove the offending material, is insufficient to impose contributory liability'.<sup>208</sup>

In respect of the allegation of vicarious copyright liability, which had not been raised specifically in the *Sony* case, the plaintiff had to show that the defendant had both the right and ability to supervise the infringing activity and a direct financial interest in such activity. Both the District Court and the Appeal Court found that Napster had a financial interest in the infringing activity.<sup>209</sup> The Appeal Court considered Napster's ability to police the infringing actions was limited but accepted that it had some ability to police and so a case for vicarious copyright liability could be shown.

The District Court had granted an injunction to stop Napster's activities and this injunction was affirmed, with some modifications, by the Appeal Court on the ground of vicarious copyright liability.

202 *A & M Records, Inc v Napster Inc* 114 F Supp 2d 896 CND Cal 2000; *A & M Records, Inc v Napster, Inc* 239 F 3d 1004 (9th Cir 2001).

203 *A & M Records, Inc v Napster, Inc* 239 F 3d 1004 (9th Cir 2001) [4427] (Judge Beezer).

204 Ibid para 4239.

205 Ibid para 4240.

206 Ibid para 4241.

207 Ibid para 4242.

208 Ibid para 4256.

209 Ibid para 4247.

In July 2001, Napster was ordered by the Court to shut down all its servers.

Napster changed the focus of how the *Sony* decision could be viewed. As noted by Ginsburg and Ricketson:<sup>210</sup>

*Sony* presented the court with an all-or –nothing challenge: either the device would be enjoined, frustrating legitimate uses, or no liability would attach, despite the infringements the device enabled. In *Napster*, by contrast, the service could disable infringing uses by blocking access to listings of protected files, while allowing permissible uses to continue. *Napster* thus transformed *Sony* into an inquiry into knowledge of and ability to prevent specific infringements.

The applicability of the *Sony* decision was also considered in *Metro-Goldwyn-Mayer Studios, Inc, and Others v Grokster Ltd, and Others*.<sup>211</sup> In 2004, a number of movie studios, music publishers and songwriters took action for copyright infringement against peer-to-peer file-sharing software distributors, Grokster Ltd and StreamCast Networks, Inc.<sup>212</sup> The plaintiffs had alleged that over 90 per cent of the files shared using the distributors' software were copyrighted material, and that 70 per cent of that material was owned by them.<sup>213</sup> Unlike Napster, the Grokster and StreamCast software did not require a central server but connected users of the software into a network. The way in which the files in the network were indexed and accessed by users differed between the two defendants.<sup>214</sup> The District Court for the Central District of California dismissed the claims and the plaintiffs appealed to the Ninth Circuit Court of Appeal.

While there was direct copyright infringement occurring over both networks, there was only constructive rather than actual knowledge of the infringement. Actual knowledge meant knowledge of specific infringing files.<sup>215</sup> The Court of Appeal found that neither defendant maintained control over the index files available for sharing and that the network would operate even if the distributors withdrew from the network.<sup>216</sup> The plaintiffs had been unable to show the defendants had actual knowledge of infringement.

As well, there was no material contribution to the infringement by the plaintiffs. They provided

neither the site nor the facilities for infringement; only the software. They could not control what users of their software did. Therefore, the Court of Appeal could not find any contributory copyright infringement.

Vicarious copyright infringement could not be found either, as although Grokster and Streamcast received a direct financial benefit from the copyright infringement and had a right to supervise infringers,<sup>217</sup> they did not have the ability to block access to users.<sup>218</sup> Nor could they filter or search for infringing files as no index information passed through the defendants' files.

So, in the end, despite the 'substantial and commercially significant non-infringing use' of the software, the Court of Appeal found its producers, Morpheus and Grokster, were not responsible for its use to breach copyright law.

However, on 10 December 2004, the US Supreme Court agreed to hear an appeal by MGM and, in June 2005, it vacated the Court of Appeal's decision.<sup>219</sup> It found that the software was used mainly for infringing purposes and there was nothing in *Sony* that required courts to ignore any evidence that indicates intention to facilitate infringement. Providing evidence showing that infringement was encouraged overcame 'the law's reluctance to find liability when a defendant merely sells a commercial product suitable for some lawful use'.<sup>220</sup>

Souter J, giving the majority judgment, noted a number of ways in which 'Grokster and StreamCast acted with a purpose to cause copyright violations through the use of peer to peer software suitable for illegal use'.<sup>221</sup> First, each company was aiming to meet the demands of the former Napster market. The name, Grokster, for instance, is a derivative of the name Napster. When marketing to potential advertisers, they promoted the potential to capture former Napster users. Second, neither company attempted to develop filtering tools or other devices to minimise infringing activity. Third, both companies made money selling advertising space and directing that advertising to the computer screens of users employing their software. The more often the software was used, the more revenue was generated by each company. They sent electronic newsletters promoting the software's ability to

210 Ginsburg and Ricketson, above n 20, 3.  
211 380 F.3d 1154 (9th Cir. 2004).

212 *Metro-Goldwyn-Mayer Studios, Inc, and Others v Grokster Ltd, and Others* 380 F.3d 1154 (9th Cir. 2004).

213 Ibid 1158.

214 Ibid 1159.

215 Ibid 1160.

216 Ibid 1161.

217 Ibid 1164.

218 Ibid 1163.

219 *Metro-Goldwyn-Mayer Studios inc. et al., Petitioners v Grokster Ltd et al*, 545 U.S. 1 (2005).

220 Ibid 18.

221 Ibid 1.

provide popular copyrighted music. They also assisted users in locating and playing copyrighted material.<sup>222</sup> These actions showed that the defendants were actively encouraging copyright infringement, proving actual knowledge of users' activities.

Although the Supreme Court unanimously vacated the Ninth Circuit Court of Appeal decision, the Justices involved in the Supreme Court decision appear to have differing views about the Sony safe harbour in relation to technologies that have or are capable of substantial non infringing uses.<sup>223</sup> Ginsburg J, in her concurring opinion on behalf of Kennedy and Rehnquist JJ, held that the 'Sony decision did not unequivocally establish blanket immunity for technologies capable of substantial non infringing uses'.<sup>224</sup> Ginsburg J questioned whether the evidence of the case established that Grokster had and was capable of non infringing uses as the lower courts concluded.<sup>225</sup> Her opinion suggests that she is less willing to leave breathing space for developers of infringing enabling technologies than the other Justices involved in the case.<sup>226</sup>

Breyer J, in his concurring opinion on behalf of Stevens and O'Connor JJ, explained why he supported the preservation of the Sony safe harbour. He believed that the Sony rule protects news technologies

unless the product in question will be used almost exclusively to infringe copyrights or unless they actively induce infringements...The Sony rule shelters VCRs, typewriters, tape recorders, photocopiers, computers, cassette players, compact disc burners, digital video recorders, MP3 players, Internet search engines and peer to peer software... Sony's rule is forward thinking and does not confine its scope to a static snapshot of a product's current uses thereby threatening technologies that have undeveloped future markets'.<sup>227</sup>

He also considered that changing the Sony safe harbour 'would significantly weaken the law's ability to protect new technology'.<sup>228</sup> To require defendants to provide evidence of 'business plans, profitability estimates and projected technological modification' would increase 'the legal uncertainty that surrounds the creation and development of new technology capable of being put to infringing

222 Ibid 20.

223 Pamela Samuelson, *Legally Speaking: Did MGM Really Win the Grokster Case?*, 4 <<http://www.ischool.berkeley.edu/~pam/papers/CACM%20SCT%20Decides%20MGM.pdf>> at 3 June 2007.

224 Ibid.

225 Ibid.

226 Ibid.

227 *Metro-Goldwyn-Mayer Studios inc. et al., Petitioners v Grokster Ltd et al*, 545 U.S. (2005) 10 (Breyer J).

228 Ibid 12.

uses'.<sup>229</sup> While a more intrusive Sony test would generally provide greater revenue security for copyright holders, Breyer J concluded 'it would be harder to conclude that the gains on the copyright swings would exceed the losses on the technology roundabouts'.<sup>230</sup> He noted that lawsuits against individual offenders file sharers appeared to be having an effect and that users were prepared to use legal sites such as iTunes'.<sup>231</sup> In view of these factors, Breyer J concluded that there was no case for changing the Sony safe harbour.<sup>232</sup>

### Australian cases

Two recent cases in Australia have considered whether the manufacturers and suppliers of technologies authorise copyright infringement by users. The first, *Universal Music Australia Pty Ltd v Cooper*,<sup>233</sup> considered the liability of a website operator for providing access to hyperlinks to unauthorised music files on a website and the liability of the ISP that provided the facilities for the website. Stephen Cooper, the defendant, operated a website that contained hyperlinks but these hyperlinks were added to Cooper's website without any direct action or intervention by him. If a user clicked on a hyperlink, the music file was automatically downloaded to the user's computer. Cooper placed a disclaimer on the website which stated, *inter alia*, that:

...when you download a song, you take full responsibility for doing so. None of the files on this site are stored on our servers. We are just providing links to remote files.

The Privacy Policy of the site also had a disclaimer which stated that:

We are not responsible for any damage caused by downloading these files, or any content posted on this website or linked websites.

Cooper had argued that merely making facilities available to individuals to allow them to communicate to others was not authorisation of infringement. Tamberlin J disagreed. He found that Cooper had actively encouraged users to download infringing material and had designed his website to facilitate this downloading. He also found that the ISP host of the website, E-Talk, had also knowingly provided the means of copyright infringement. Both Cooper and the ISP had failed to take reasonable action to prevent the

229 Ibid.

230 Ibid 13

231 Samuelson, above n 71, 5.

232 Ibid.

233 [2005] FCA 972.

infringements occurring by removing or screening offending hyperlinks.

Cooper had control over his website and so could have prevented the infringement from occurring. The use of the disclaimers on the website indicated his knowledge of the existence of illegal MP3 files on the Internet and the likelihood that his website could contain links to them.<sup>234</sup> Tamberlin J concluded, using the words of Gibbs J in *Moorhouse* at 13, that Cooper:<sup>235</sup>

abstained from action which under the circumstances then existing it would have been reasonable to take, or ... exhibited a degree of indifference from which permission ought to be inferred.

Tamberlin J also considered the defence to authorisation contained in s 112E which states that a person who makes facilities available is not taken to have authorised copyright infringement merely because someone uses the facilities to do so. He accepted the applicants' argument that it did not apply to Cooper's activities. Cooper was not merely providing facilities; he was encouraging users to infringe copyright by offering references to downloading on his website and had designed his website to facilitate it.<sup>236</sup>

The ISP was also refused a defence under s 112 as it was aware of the infringement occurring, due to its commercial arrangement for free hosting of Cooper's site in exchange for advertising on it.<sup>237</sup>

The respondents had also argued that they were entitled to rely on the safe harbour provisions in Div 2AA of Part V of the Copyright Act but this was rejected as the amendments were not retrospective. Tamberlin J, however, observed that the respondents could not have relied on its protection in any case as they had failed to adopt and reasonably implement a policy to terminate the accounts of repeat offenders, had received financial benefit directly attributable to the infringing activity which they had the right and ability to control, and had taken no action to remove or disable links being used to infringe.<sup>238</sup>

On appeal, the Full Court of the Federal Court of Australia upheld Tamberlin J's decision and the orders against Cooper and the ISP.<sup>239</sup> Branson and Kenny JJ, in deciding whether Mr Cooper had authorised copyright infringement, addressed the

specific matters to be considered as provided in s 101(1A). Branson J considered that Cooper had the power to prevent infringement by users. She referred to *Moorhouse* and suggested that Jacobs and Gibbs JJ in that case concentrated on the decision by the university to make the copier available for use in the library, rather than on the issue whether, having made it available, they had the capacity to control its use.<sup>240</sup> In her opinion, this is the purpose of s 112E. The section provides that, if you make a communication facility available then that provision alone is generally not enough to be considered authorisation.<sup>241</sup> But Cooper went beyond merely making his website available; he made available 'a technical capacity calculated to lead to copyright infringement'.<sup>242</sup> Cooper deliberately chose not to have the power to prevent infringement. Kenny J noted that 'Cooper's position was... entirely different from that of the manufacturers and vendors of blank tapes'.<sup>243</sup>

In considering the second limb of s 101(1A) concerning the nature of a relationship between provider and user, Branson J agreed with the trial judge that Cooper worked hard to make his website attractive and easy to use.<sup>244</sup> She and Kenny J also agreed that Cooper did not establish that he had taken reasonable steps to avoid infringements.<sup>245</sup>

E-Talk, the ISP associated with Cooper's website, and its Director, Mr Bal, appealed against Tamberlin J's order against them on the grounds the judge had erred in not applying s 112E to them. Branson J found that the trial judge had correctly not applied the safe harbour provided by s 112E to E-Talk based on his finding that E-Talk was aware of the infringing activity being conducted on Cooper's website, that there was a close business relationship between E-Talk and Cooper's site and that E-Talk took no action to prevent the infringing activity.<sup>246</sup> The matters raised in s 101(1A) relating to power to prevent, existence of a relationship with the infringers and failure to take reasonable steps to prevent infringement applied equally to E-Talk.<sup>247</sup>

Kenny J considered the meaning of 'merely because' in s 112E.<sup>248</sup> He believed it meant that:

240 Ibid para 36.

241 Ibid para 39.

242 Ibid para 41.

243 Ibid para 49.

244 Ibid paras 46-47.

245 Ibid paras 49-51, 152-153.

246 Ibid para 58-59.

247 Ibid para 61-65.

248 Ibid para 161.

234 *Universal Music Australia Pty Ltd v Cooper* [2005] FCA 972.

235 Ibid para 87 (Tamberlin J).

236 Ibid para (Tamberlin J).

237 Ibid para 131.

238 Ibid paras 105-108.

239 *Cooper v Universal Music Australia Pty Ltd* [2006] FCAFC 187.

if the most that can be said is that they have provided the facilities another person has used to infringe copyright, they are not to be taken to have authorized the infringement.<sup>249</sup>

In this case, the appellant ISP was doing more than just providing facilities. The facts of each case may result in an ISP being an authoriser despite s 112E.<sup>250</sup>

The second case, *Universal Music Australia Pty Ltd v Sharman License Holdings Ltd* (the Kazaa case),<sup>251</sup> concerned the activities of the Kazaa Internet peer-to-peer file-sharing system which enabled users to share digital material without cost whether or not the material is subject to copyright. In 2004, Universal Music and 29 other applicants sought injunctions against ten respondents, including Sharman Networks, the company controlling Kazaa. The applicants alleged, *inter alia*, that users of the software were infringing their copyright and that the applicants, by providing the file sharing software, were engaging in copyright infringement.

One of the allegations by the applicants was that Sharman Networks provided the Kazaa software to users 'knowing and intending that, or being recklessly indifferent as to whether' Kazaa users would infringe copyright.<sup>252</sup> This allegation is directly relevant to the issue of how much responsibility the technology provider needs to bear for any infringement that arises from the way their technology is used by others.

In summarising the major factual issues in the case, Wilcox J noted that, by the end of the trial, there was no real dispute that the respondents knew the Kazaa system was being used extensively to transmit copyright material.<sup>253</sup>

He stated:

In short, I find that all respondents knew that the predominant use of Kazaa was for the sharing of copyright-infringing material. None of them had an interest to prevent or curtail that predominant use; if anything, the contrary. Each of the respondents was at least acquiescent in the use of Kazaa for copyright-infringing activities.<sup>254</sup>

249 Ibid para 168.

250 It should be noted that on 23 January 2007 an application was filed with the High Court seeking leave to appeal the Full Federal Court's decision.

251 [2005] FCA 1242.

252 *Universal Music Australia Pty Ltd v Sharman License Holdings Ltd* [2005] FCA 1242, para 36.

253 Ibid para 137.

254 Ibid para 194.

While Wilcox J did not consider that the respondents could be said to be engaged in actual copyright infringement, he found that six of the respondents had authorised copyright infringement. First, he found that they knew that substantial copying was being undertaken by users. They might post warnings against copyright infringement on their website and might require users to agree to licence agreements that they wouldn't infringe copyright but it must have been obvious that these warnings were not effective. Second, the respondents had not implemented any of the available technical measures which might have reduced the incidence of copyright infringement. Third, two of the respondents, Sharman Networks and Altnet, had sponsored a web campaign attacking the record companies and their opposition to the sharing of copyright music files.

Sharman's defence to the allegations of authorisation of copyright infringement was that the Kazaa Software was content neutral, that it was capable of being used to download files that did not infringe copyright and that they had no control of either the files which users might make available in their shared folders or the content they search for and download.<sup>255</sup> However, technical experts for both sides agreed that it would be possible to redesign the Kazaa software to enhance the optional keyword filters to become non-optional, noting however, that 'the introduction of such filters would not prevent the distribution of some unauthorised material'.<sup>256</sup>

The most contentious factual issue in the case was, in the view of Wilcox J, whether there was a Kazaa 'central server'.<sup>257</sup> Sharman denied, and the applicants failed to prove, the existence of such a server. One implication of this is that Wilcox J was not able 'to conclude that it would be practicable for Sharman 'to implement a satisfactory system of obtaining particulars of users' identities'.<sup>258</sup>

Wilcox J discussed what constituted authorisation of copyright infringement in some depth. He noted that, while knowledge of infringement was an important factor in determining authorisation, it was not a conclusive factor.<sup>259</sup> He quoted Sackville J in *Nationwide News Pty Ltd v Copyright Agency Limited*<sup>260</sup> who said: 'Nonetheless, a

255 Ibid para 52.

256 Ibid para 129.

257 Ibid para 196.

258 Ibid para 249.

259 Ibid para 370.

260 (1996) 65 FCR 399.

person does not authorise an infringement merely because her or she knows that another person might infringe the copyright and takes no step to prevent the infringement'.<sup>261</sup>

What is important is the extent of the control over the activities of the infringer exercised by the provider or manufacturer of the technology.<sup>262</sup> Section 112E of the *Copyright Act* provides that the respondents are not to be held to have authorised copyright infringement by Kazaa users merely because they provide the facilities used to infringe copyright.<sup>263</sup> For authorisation to be proved, something more on the part of the respondents is needed – the sanctioned, approved, or countenanced test approved in the *Moorhouse* case.<sup>264</sup>

Counsel for the Amici<sup>265</sup> argued that, due to ss 22(6) and 112E, the sections of the Act which 'protect the messengers', it would be wrong to require software providers to monitor for infringement. It was argued that this requirement would remove the motivation for copyright holders to protect one's property and move the burden of enforcement to third parties.<sup>266</sup> Wilcox J noted:

I accept that Parliament intended to 'protect the messenger', although only to the extent indicated by the Act; notably s 112E. However, on my findings, Sharman is and was more than a 'messenger'.<sup>267</sup>

Wilcox J found that, knowing Kazaa users were infringing copyright, the respondents undertook positive acts to encourage that infringement, including promotion of file sharing to their users and criticising the attitudes of music companies.<sup>268</sup> He acknowledged that the Kazaa website contained notices stating that Sharman did not 'condone activities and actions that breach the rights of copyright owners' and that users were referred to an end user licence agreement and had to indicate agreement to be bound by it by clicking a box.<sup>269</sup> However, a focus group report had made it clear that users ignored the notice and the licence, and they were obviously failing to deter copyright infringement. It was at this stage that Wilcox J considered Sharman should have acted

to prevent or reduce the infringing behaviour, possibly through increased filtering. They took no action.

While Wilcox J acknowledged the similarities between the systems used by Kazaa, Grokster and StreamCast, he considered that the *Grokster* judgment did not provide any assistance given that Australian statutory law had no counterpart in American law.<sup>270</sup> One commentator highlighted that the *Kazaa* case is different from *Grokster* in one aspect in that the Australian case went to a full trial while the *Grokster* decision was a summary judgement, sending the case back to the lower courts for further consideration.<sup>271</sup> As well, full information was available about how much control Sharman Networks could exercise over the activities of the users of Kazaa. By establishing that Sharman Networks did have control, the issue of liability was determined without considering the issue of inducement as discussed in *Grokster*.<sup>272</sup>

The respondents were ordered to cease authorising Kazaa users in Australia from infringing copyright. In particular, they were ordered to ensure that within two months non-optional filter technology was incorporated into all new versions of Kazaa software and that 'maximum pressure' was placed on existing users of Kazaa software to upgrade their existing software to the new version. Appeals against Wilcox J's decision were lodged by both plaintiffs and defendants and, as well, the plaintiffs lodged a notice of motion against the defendants seeking punishment for contempt of court for failure to introduce filtering to stop searching for unauthorised files and to apply pressure on existing users to upgrade to new software containing appropriate filters.<sup>273</sup> In March 2006, the Full Federal Court found that Wilcox J was entitled to make a finding of contempt against Sharman Networks in respect of its failure to implement his orders.<sup>274</sup> The substantive hearing of the appeal is still awaited.

On 27 July 2006, Sharman Networks reached a settlement in respect of both the *Universal Music v Sharman Networks* and the *MGM v Grokster Ltd* in

261 *Nationwide News Pty Ltd v Copyright Agency Limited* (1996) 65 FCR 399, para 370.

262 *Australasian Performing Right Association Ltd v Metro on George Pty Ltd* (2004) 61 IPR 575, para 73 (Bennett J).

263 *Ibid* para 401.

264 *Ibid* para 402.

265 Mr G. McGowan SC and Ms L. De Ferrari representing the Australian Consumers Association Pty Ltd, Electronic Frontiers Australia Inc and the NSW Council for Civil Liberties Inc.

266 *Universal Music Australia Pty Ltd v Sharman License Holdings Ltd* [2005] FCA 1242 para 416

267 *Ibid* para 418.

268 *Ibid* para 405.

269 *Ibid* para 407.

270 *Ibid* para 29-30

271 K Weatherall, 'So the US Supreme Court has handed down judgment in *Grokster*, What is there in this judgment for an Australian audience in particular?' *Weatherall's Law: IP in the land of Oz (and more)* <[http://weatherall.blogspot.com/2005\\_06\\_01\\_weatherall\\_archive.html#111991650961635918](http://weatherall.blogspot.com/2005_06_01_weatherall_archive.html#111991650961635918)> at 22 February 2006.

272 *Ibid*.

273 *Universal Music Australia Pty Ltd v Sharman Networks Ltd* [2006] FCA 29; *Brendon Scott, Kazaa: Time to Rethink Authorization?* <<http://opensourcelaw.biz/publications/papers/bscott%20kazaa%20udgment%20first%20instance%20050910%20lowres.pdf>> at 17 November 2006; *Sharman Networks Ltd v Universal Music Australia Pty Ltd* [2006] FCA 1.

274 *Universal Music Australia Pty Ltd v Sharman Networks Ltd* [2006] FCAFC 41.

the US, agreeing to pay over \$100 million and to implement 'robust' filtering technologies to block out illegal content.<sup>275</sup>

### Impact of Decisions on Authorisation and File Sharing

The *Cooper* and *Kazaa* cases both dealt with fairly blatant examples of intent to authorise copyright infringement, although the scale of activity was markedly different. While Wilcox J did not specifically discuss the three factors set out for consideration in s 101(1A), he did address them in a number of ways. He was satisfied, for instance, that Sharman Networks had the power to prevent the infringing activity, not only technically but also by ceasing to encourage users, through the web campaign 'Join the Revolution' and through rewarding high user participation. He was convinced that the relationship between Sharman Networks and its users was based on a need to ensure and maintain financial returns. Finally, he found that the whole business model of Kazaa was based on increasing infringement instead of preventing users infringing. He dismissed the user notices, licences and warnings as being token attempts to deter infringement.

In *Cooper*, the Full Federal Court did specifically address the three factors in s 101(1A). It found that Cooper and E-Talk had the power to prevent infringement by users but deliberately chose not to exercise that power. In considering the second limb of s 101(1A) concerning the nature of a relationship between provider and user, it agreed that Cooper worked hard to encourage users to visit the web site and to make use of its facilities. Finally, it was clear that Cooper was unable to show that he had taken reasonable steps to avoid infringements.

In neither case, nor, in fact, in *Grokster*, was there any real doubt that the intent of the respondents was to use their sites or software to encourage users to infringe copyright. They had knowledge of the infringing activity, encouraged it due to the financial benefits they received and made no attempt to deter it. In both *Cooper* and *Kazaa*, the respondents attempted to argue they had no power to prevent the activity and therefore no

control over it. As noted above, in many of the file sharing cases, like *Napster* and *Grokster*, this issue of control and the attempts of respondents to make it difficult or impossible to control has been crucial. However, the various attempts by respondents to make it hard for them to be able to control infringing activity have not been successful.

The cases discussed above are not saying that all providers of file sharing software and other technology that can be used to infringe copyright will be found to have authorised copyright infringement. At this stage, mere distribution of or making available a product or technology which can be used by others to infringe copyright will not be held to be authorising copyright infringement should it occur. However, when a provider has control over the technology's use and knows that infringement is occurring, then it may be liable, depending on the extent of both its control and its knowledge of what is occurring.

In *Grokster*, *Cooper* and *Kazaa*, the defendants' income came from encouraging and even inducing infringement. While knowledge that copyright infringement might occur or even that it is likely to occur will not necessarily amount to authorisation, even if one takes no action to prevent it.<sup>276</sup> Actual knowledge of actual infringement which could be prevented if one acted to do so is likely to be considered authorisation.

The discussion in both cases about the operation of s 112E and the possible extent of the safe harbour provided by it to ISPs and other such communication providers has been valuable but leaves some uncertainty. The evidence of the respondents' intentions found by the courts in documents and in actions showed that their activities went beyond mere distribution. Something more than merely providing a means by which users can communicate will be needed but how that 'something more' will be determined will depend on the facts in future cases.

### Where to Now for Producers and Manufacturers of Technology on the Internet?

Every decision in this area appears to have led to changes in how the P2P businesses have been designed.<sup>277</sup> *Grokster* and *Kazaa* both arose out of the lessons from the *Napster* decision.

Following the successful proceedings against the providers of the *Grokster* and *Kazaa* software, in

275 MIPI, *Australian Recording Industry Announces Historic Global Pay-Out from Kazaa*, (Media Release 27 July 2006) <<http://www.mipi.com.au/documents/kazaa27072008.pdf>> at 17 November 2006; Sharman Networks, *Content Industries and Sharman Networks Settle All Global Litigation* (27 July 2006) <<http://www.sharmannetworks.com/content/view/full/323>> at 17 November 2006; OUT-LAW News, *Kazaa to Pay \$100 million and go Legal in Landmark Piracy Settlement* (27 July 2006) <<http://www.out-law.com/page-7143>> at 17 November 2006.

276 *Nationwide News Pty Ltd v Copyright Agency Limited* (1996) 65 FCR 399.

277 Gibling-Chen and Davison, above n 20, 69.

which both the Australian and US courts found that the defendants had intended their software to be used to infringe copyright, the music industry targeted other peer-to-peer networks including LimeWire,<sup>278</sup> eDonkey, and Overnet.<sup>279</sup> At the same time, other networks such as BitTorrent entered into agreements with music companies to distribute authorised content,<sup>280</sup> as did the social networking site, MySpace.<sup>281</sup>

The area of peer-to-peer sharing software is a recent phenomenon and changes occur rapidly. New processes for allowing users to access music and film files appear rapidly and can attract millions of users in a short space of time. Napster, the precursor to the Kazaa software, was only developed in 1999 and was closed down in 2001. Kazaa took over many Napster customers but it was alleged that, by August 2005, it held only 10 per cent of the market.<sup>282</sup>

The two most important recent filesharing entrants are MySpace and YouTube. The current MySpace service was founded in July 2003 and is the fourth most visited English language website.<sup>283</sup> It was purchased by News Corp in late 2005. It has over 100 million user accounts.<sup>284</sup> YouTube first appeared in early 2005 and has now exceeded MySpace in popularity.<sup>285</sup> YouTube was developed as a medium for creators of videos to share their work but now a vast number of the videos uploaded and viewed are not created by the poster but are clips of music videos and television programs.<sup>286</sup> It was purchased by Google in November 2006.

Universal filed a lawsuit against MySpace on the 17 November 2006, alleging the site allows users to upload unauthorised videos and other content and then assists them by reformatting the videos

for access by other users.<sup>287</sup> Universal alleges MySpace, News Corporation and ten John Does are involved in 'direct, contributory, and vicarious copyright infringement ... inducement of copyright infringement, and ... violations of the Californian Business and Professions Code'.<sup>288</sup> MySpace does has Terms of Use on its website that state that only content to which users have a right to grant MySpace a licence to use can be posted on the site but Universal claims this is a sham. It alleges that MySpace knows that members post unauthorised content. Moreover, the site provides tools to assist users to load videos and other content, to reformat them and to disseminate them.<sup>289</sup> MySpace 'encourages, facilitates and induces the uploading of thousands of copyrighted songs and videos by its members each day onto servers that it owns and controls'.<sup>290</sup> It also allows users to make anonymous postings of content.

In respect of the allegation of vicarious liability, Universal notes that MySpace states it may 'pre-screen songs and videos for content and expressly reserves the right 'to reject, refuse to post or remove any posting: and 'to monitor the MySpace servers'.<sup>291</sup> As well, it claims that MySpace receives millions in advertising revenue from the operation of the site and plans to expand it.

MySpace argues that it has put into place appropriate procedures for removing unauthorised files as required under the copyright law. This response means that MySpace is attempting to reply on the 'safe harbour' protections contained in s 512 of the DMCA which provides that ISPs are not to be held to have authorised copyright infringement by users merely because they provide the facilities used to infringe copyright. This safe harbour protection applies unless it can be shown that the provider has encouraged the infringement.

In October and November, YouTube agreed to remove 30,000 files after complaints against copyright infringement by The Japan Society for Rights of Authors, Composers and Publishers in October. It has agreed to use new technology that can identify copies of licensed clips and remove them automatically, and is negotiating with the German music performers' society over royalties

278 OUT-LAW News, *Music Industry has "Strong Case" Against LimeWire* (7 August 2006) <<http://www.out-law.com/page-7172>> at 17 November 2006.

279 PCPro, News, *eDonkey Put Out to Grass* (14 September 2006) <<http://www.pcpro.co.uk/news/93674/edonkey-put-out-to-grass.html>> at 18 September 2006

280 Ibid.

281 OUT-LAW News, *MySpace tries to block unauthorised tunes*, 1 November 2006, <http://www.out-law.com/page-7437>, 3 November 2006.

282 Michael Geist, 'IPR world awaits ruling in Kazaa case in Australia', 5 September 2005, <http://www.taipetimes.com/News/worldbiz/archives/2005/09/05/2003270490>, cited in Brendon Scott, 'Kazaa: Time to Rethink Authorization?', <http://opensource.law.biz/publications/papers/bscott%20kazaa%20judgment%20first%20instance%20050910%20lowres.pdf>, p 4, accessed 17 November 2006.

283 <http://en.wikipedia.org/wiki/MySpace>, accessed 20 November 2006.

284 Ibid.

285 Ibid.

286 Ibid.

287 Reuters, 'Universal sues MySpace over copyright', *The Australian Financial Review*, 20 November 2006, 50.

288 UMG Recordings, Inc., et al v MySpace, Inc., et al, 17 November 2006, District Court California (Case No CV06-07361).

289 Ibid para 4.

290 Ibid para 13.

291 Ibid para 18.

for unauthorised videos.<sup>292</sup> It reached licensing agreements with Warner, Sony BMG, CBS and the Universal Music Group in October 2006, to allow users access to authorised music and video files.<sup>293</sup>

In April 2007, Viacom brought a lawsuit against YouTube and its owner, Google, for copyright infringement. Viacom claims that its television and movie clips have been viewed on YouTube more than 1.5 billion times without its permission.<sup>294</sup> It is arguing that YouTube's strategy has been to avoid taking proactive steps to curtail the infringement on its site, thus generating significant traffic and revenues for itself while shifting the burden and cost of monitoring YouTube onto the victims of copyright infringement.<sup>295</sup>

## Conclusion

The law in Australia and the US in respect of the authorisation of copyright infringement by others may differ in both the approaches and the elements needed to prove authorisation in each jurisdiction.<sup>296</sup> The Australian Copyright Act sections which deal with authorisation of copyright infringement of works and subject matter other than works, ss 36A and 101(1A), require the courts to consider the extent of a person's power to prevent the infringement, the relationship between the alleged authoriser and the infringer, and the steps, if any, taken by a person to ensure others cannot infringe.

American contributory infringement has been developed by the courts and requires the authoriser to have knowledge of an infringement and to have materially contributed to that infringement. As well, the US courts recognise the offence of vicarious copyright infringement whereby the defendant has to be shown to have controlled the infringing activity in some way and to have a direct financial interest in such activities.

292 OUT-LAW news, 'German Music Publishers Demand YouTube Royalties' (9 November 2006) <<http://www.out-law.com/page-7460>> at 17 November 2006.

293 Nate Anderson, *YouTube Signs up Universal, Sony BMG, CBS, and ...Google?* (9 October 2006) <<http://arstechnica.com/news.ars/post/20061009-7935.html>> at 26 November 2006.

294 Out-Law.COM, *Viacom's YouTube Lawsuit Could Test Limits of DMCA 1* <<http://www.out-law.com/default.aspx?page=7427>> at 2 April 2007.

295 Ibid.

296 Wilcox J in *Kazaa* pointed out at para 414 that Australian Copyright Law contained no equivalent to the doctrine of contributory copyright negligence and so the issue was not relevant to the case. He also noted at para 30 that the facts in *Grokster* were sufficiently different to render that decision of little assistance to him.

Despite these differences, there is considerable similarity in the way the courts in both jurisdictions have handled allegations of authorisation of copyright infringement in the online context. The extent of knowledge of the defendant about what is actually happening and the extent of control over the technology have been the key issues considered in both countries.

Authorisation in P2P cases involves challenges not necessarily faced by the courts in *Sony*<sup>297</sup>. *Sony* involved the manufacturer of a technological product which could be used for a number of infringing and non-infringing purposes by its purchasers. The manufacturer earned an income through the sale of the product. The P2P cases involve a provider of software to users for the primary purpose of earning income through users' infringing activities. The defendants' whole business model was designed around authorising infringement. The courts in two jurisdictions have responded in similar ways, by restricting the activities of the defendants in the situation before them. They did not attempt to restrict the dissemination of the P2P technology itself.

The extent of the defendant's control over and knowledge about infringing activities were the key issues for the courts in the US. In Australia, the issue of control is addressed by the first two limbs of s 101(1A), relating to the extent of power to prevent infringement and analysis of the relationships between the two parties. The *Sony* approach, however, that if the new technology has substantial non-infringing uses, then the onus really lies with the user to choose how he or she will use the technology, is valid in both jurisdictions. In such cases, the provider has little or no power to influence and control use as it lies with the user, even though the provider knows that the technology can be used for infringement. There are numerous examples of this. *Naphthali* refers, for example, to the free provision of Outlook email software by Microsoft.<sup>298</sup> Microsoft and other email software vendors know that their software can be used for infringing purposes, but they are not directing how the software is to be used.

Some technology providers actually control some aspects of how a user is to act once they purchase or obtain the product. Apple's iTunes is a good example. Apple provides the technology, the software and the content and sets the rules about how they are to be used by purchasers. These

297 A similar case is *CBS Songs Ltd v Amstrad Consumer Electronics plc* [1988] AC 1013.

298 *Naphthali*, above n 4, 34.

rules are enforced by a digital rights management system. There are, however, many ways in which Apple's iPod can be used by individual users for infringing purposes but these uses are outside the controlled environment created by Apple.<sup>299</sup>

The P2P cases of *Kazaa*, *Cooper* and *Grokster*, however, describe environments created by the defendants which encouraged copyright infringement as the primary use of the software.

It cannot be stated that the law relating to authorisation of copyright infringement has been made stricter as the capabilities of such infringing technology have become known. However, we have begun to understand how the new technologies can be used to both encourage and to limit infringing activities, and the extent to which positive action is taken by providers of the technology will be an important factor to be considered by the courts, particularly in cases where substantial revenues are been earned by those providers through those activities.

As well, in response to recent peer to peer file sharing cases, the Australian Government in late 2006 recently introduced significant criminal and civil penalties for commercial scale Internet infringements.

The *Copyright Amendment Act 2006* introduced ss 115(5), (6), (7) and (8) which gives the courts additional power to grant relief to copyright owners in civil actions in certain commercial scale Internet infringement cases.<sup>300</sup> Civil remedies are available to the copyright owner if the court is satisfied that the following conditions are met:

- The respondent has committed an infringement (including by authorisation),
- It involved a communication of a work or other subject-matter to the public,
- Because of this communication, it is likely there were other infringements of the copyright by the defendant that the plaintiff did not prove,
- Taken together, the proved infringement and the likely infringements occurred on a commercial scale.<sup>301</sup>

Section 115(5)(c) is considered broad enough to capture 'commercial scale Internet infringement that can occur through peer to peer file sharing or by way of hypertext linking or downloading from remote website'.<sup>302</sup> To be granted relief under s

115(5)(d), the courts must consider whether or not the infringement has occurred on a commercial scale. Under s 115(6), once actual infringement is established, likely infringement can be used to meet the commercial scale threshold. Section 115(7) provides guidance to courts in determining if the infringement has occurred on a commercial scale.<sup>303</sup>

New indictable, summary and strict liability offences relating to the making of an infringing copy commercially has been introduced under s 132AD of the *Copyright Amendment Act 2006*.<sup>304</sup>

In order to avoid liability, it will be important for technology providers in future cases to demonstrate that they received a financial return from the technology use regardless of the infringement rather than receiving a financial return because of the infringement.

299 There are anti-competitive issues as well as concerns about the 'first sale'; or 'principle of exhaustion' copyright doctrine associated with iTunes but these are beyond the scope of this paper.

300 Explanatory Memorandum, Copyright Amendment Bill 2006 (Cth) 90.

301 Ibid.

302 Ibid, 91.

303 Ibid.

304 Ibid, 21.

## Case note: Sons of Gwalia v Margaretic

### Introduction

On 31 January 2006 the High Court of Australia, by a majority of 6 to 1, ruled that a purchaser of shares in a listed public company that later went into liquidation could, if full disclosure had not been made to the ASX, claim loss in equal priority with the general pool of unsecured creditors.

The case of *Sons of Gwalia & ING Investment Management v Margaretic*<sup>305</sup> is an important case that has, no doubt, put the 'cat amongst the administrators' pigeons'.

### The Facts

The case concerned two combined appeals against successful claims by Mr. Margaretic in the Federal Court. According to Gummow J's helpful summary of the facts,<sup>306</sup> Margaretic bought shares in the First Appellant's gold-mining company eleven days before the company appointed administrators and went into liquidation. The company, Margaretic claimed, knew (and ought to have disclosed) the fact that it did not have sufficient gold supplies to discharge its obligations under gold futures contracts. This was something that ought to have been disclosed as it would obviously, at the very least, put the company into serious financial jeopardy.<sup>307</sup>

Accordingly Margaretic sued for various 'misleading and deceptive conduct' breaches of the Trade Practices Act, Corporations Act and ASIC Act,<sup>308</sup> based upon the above facts.

### The Majority Judgment

Of the judges of the court, Gleeson CJ, Gummow J, Kirby J, Hayne J, Heydan J and Crennan J all ruled that Margaretic could attempt to prove his claim for damage alongside unsecured creditors. Given that Heydon J,<sup>309</sup> and Crennan J,<sup>310</sup> Gummow J<sup>311</sup> defer to Hayne J, it can be said that if any judgment represents the majority reasoning, it must be that of Hayne J.

305 High Court of Australia, 31 January 2007, S208/2006 & S209/2006

306 At paragraph 8 of His Honor's judgment.

307 Or equally likely, as in the present case, into liquidation.

308 Per Gummow J at paragraph 8.

309 At paragraph 260.

310 At paragraph 265.

311 At paragraph 46.

The question upon which all the judgments turned was the correct interpretation of section 563A of the Corporations Act 2001 (C&L), which states:

Payment of a debt owed by a company to a person in the person's capacity as a member of the company, whether by way of dividends, profits or otherwise, is to be postponed...

The majority found that a debt owed to shareholders for breach of statutory duties against misleading or deceptive conduct (or, possibly, non-disclosure) is not a debt owed to that shareholder 'in the person's capacity as a member of the company...'.<sup>312</sup>

Hayne J gives a narrow interpretation to section 563A. He suggests that if money is paid 'under the statutory contract, there may be cases in which...it is...one whose ultimate foundation is the legislative prescription of rights of members.'<sup>313</sup>

This reasoning, which must be viewed currently as authoritative, appears to mean that (outside of dividends and profits) shareholders will only be postponed in some cases where the basis of the claim is the members statutory contract with the company.

Additionally, according to Hayne J, there is no validity for distinguishing between misleading and deceptive statements to subscribers of shares in original capital offers and purchasers of shares on the market: in all such cases both subscribers and purchasers will be able to attempt to prove in liquidation without postponement.<sup>314</sup>

### Critique of The Majority

The majority position can be questioned from both the both the perspective of public policy and on strictly legal grounds.<sup>315</sup>

312 Gleeson CJ says membership 'was not definitive of the capacity in which he made his claim' at paragraph 31; Hayne J expresses words to the same effect at paragraph 206 as does Gummow J at paragraph 25; Kirby J at paragraph 121 suggests "the application...depends in every case on the facts and circumstances of the 'debt' in question," reasoning which he then attributes to Hayne J; Heydon concurs with Hayne J at paragraph 260, and Crennan concurs with Hayne J and Gleeson CJ at paragraph 265.

313 At paragraph 205.

314 At paragraph 205.

315 For a more detailed analysis of such arguments see Harris, Jason & Hargovan, Anil, 'Sons of Gwalia: Navigating the line between membership and creditor rights in corporate insolvencies' (2007) 25 C&SLJ pp. 7-29.

From a public policy perspective, the decision has already led administrators to voice their concern about the effect of the case, being delays in winding-up and excessive complexity due to the potential for numerous shareholder claims.<sup>316</sup> The fact is that, as Callinan points out,<sup>317</sup> those who seek to profit from their investments ought also to wear the loss of their investments if things go bad. It is (as Callinan also says) unfair to undermine the capital available for distribution to unsecured creditors, not to mention the fact that it could severely stifle the willingness of corporations and individuals to contract with publicly listed companies in high-risk industries such as precious metal prospecting and mining.

The entire history of the common law recognised the principle of creditor priority. The majority's dismissal of this, and in particular their avoidance of their own decision thirteen years previously,<sup>318</sup> is unfortunate. It is true that much of the corporations law of previous centuries is today inapplicable- but not so in relation to priority disputes.

On a more positive note, it was helpful that the majority did not follow Gleeson CJ's<sup>319</sup> lead and attempt to distinguish *Webb Distributors* on the grounds that the latter was a case of the issue of share capital. Such a distinction would have been arbitrary, to say the least.

### Callinan J's Dissent

The judgment of Callinan J begins with surprisingly color, describing, in its conversational style, shareholders as being 'impelled to make as much money...as possible.'<sup>320</sup>

Despite including at times distractingly complete extracts of sections of the Act of arguable relevance,<sup>321</sup> and modest self-referential quoting,<sup>322</sup> Callinan J's conclusions are, it is submitted, to be preferred to those of the majority.

His Honor's interpretation of the term 'or otherwise' as expansive, rather than limited<sup>323</sup> is correct, and although the majority judgments do

not explicate it, this author submits that the phrase becomes redundant under their interpretations (because under their inter-pretations it is really only the explicated items of dividends and profits that could be debts owed to shareholders in their capacity as such).

His Honor is, it is submitted, correct in pointing out that *Webb Distributors* cannot be distinguished with any legitimacy based on the distinction between the issuing of new shares in *Webb Distributors*, and the secondary market acquisition in the present case. Further, His Honor's disapproval of *Soden*,<sup>324</sup> and of the majority decision in general,<sup>325</sup> as undermining the the maintenance of company capital available to creditors,<sup>326</sup> is compelling. His Honor's assertion that in many (or possibly almost every?) case of corporate collapse, the majority of then current shareholders will have a claim following the majority reasoning<sup>327</sup> is correct. Given this, one wonders whether the matter won't have to be re-litigated in the future if the legislature does not step in.<sup>328</sup>

### Conclusion

From the discussion above, it is clear that the majority of the High Court has radically changed the law in relation to priority rights between shareholders and unsecured creditors. This brings Australian law into consistency with the law in the United Kingdom, but represents a departure from relatively recent Australian precedent.

It has been submitted in arguments above that it is not desirable for the law to allow shareholders who claim misrepresentation caused them to acquire shares, and who now seek a 'slice of the pie,' to have equal priority with unsecured creditor's in liquidation.

However, given the majority's ruling in this case, it may well fall to the legislature to either accept the decision (and, possibly, codify it) or legislate to override the decision.

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316 Tony Hodgson in 'Queue jumping: how the High Court changed the rules', 28 February 2007, The Age Newspaper, Business section, <http://www.theage.com.au/news/business/queue-jumping-how-the-high-court-changed-the-rules/2007/02/27/1172338626836.html>

317 And see below for a discussion.

318 *Webb Distributors (Aust) Pty Ltd v Victoria* (1993) 179 CLR 15.

319 At paragraphs 31 & 32.

320 At paragraph 208.

321 For instance, section 232 of the Corporations Act at paragraph 234 of His Honor's judgment.

322 "As I said in *New South Wales v Commonwealth*" at paragraph 244 of His Honor's judgment.

323 At paragraph 249.

324 *Soden v British and Commonwealth Holdings plc* [1995] 1 BCLC 686.

325 At paragraph 253.

326 At paragraph 253.

327 At paragraph 256.

328 In fact the issues raised in this case have been referred to Corporations and Markets Advisory Committee (CAMAC) see 'Queue jumping: how the High Court changed the rules', 28 February 2007, The Age Newspaper, Business section, <http://www.theage.com.au/news/business/queue-jumping-how-the-high-court-changed-the-rules/2007/02/27/1172338626836.html>

## Book Review

*Daniel Khoury and Yvonne Yamouni, Understanding Contract Law,  
7<sup>th</sup> Ed, LexisNexis/Butterworths*

The text, 'Understanding Contract Law', is one of the most popular books on contract law in Australian tertiary institutions because it helps to explain complex contract legal issues in a way that can be easily understood by both business and law students. It started out as a text directed at business and accounting students because commercial law consisted of mainly 'contract law' and it has now grown into a very useful text for law students as well. The text includes an innovative approach to flow charts at the start of each chapter as well as relevant questions and further reading resources at the end of each chapter.

Business law students as well as accounting, legal and business professionals should find the coverage of contract law easy to read and

comprehend as a result of the way in which it is written and set out on the page. The only criticism that could be made is that the discussion on statutory law, the Trade Practices Act and Fair Trading Acts, relating to certain areas of contract law such as the implied terms and conditions, could be dealt with in more detail. However, it is understandable that these are only mentioned briefly as the book is about the common law of contract. All of the most recent Australian cases are included in the recent edition and it is worthy of recommendation.

John McLaren

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The Commercial Law Journal focuses on a range of commercial law issues of relevance to legal and accounting practitioners and academics, and to those working in the financial planning and financial services area. Articles in the Journal cover issues in corporations law, contract law, taxation, intellectual property, corporate governance, and securities and investment law.

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