

ASIC CASE UPDATE

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INTRODUCTION

- ▶ Focus on events occurring since 1 January 2016
 - Level of familiarity assumed
 - For general principles, see publications (justin.brereton@vicbar.com.au):
 - ASIC's approach to securities litigation
 - ASIC's growing sphere of influence
 - Company Directors – Civil Penalties and Criminal Sanctions
- Feel free to contribute / ask a question at any time

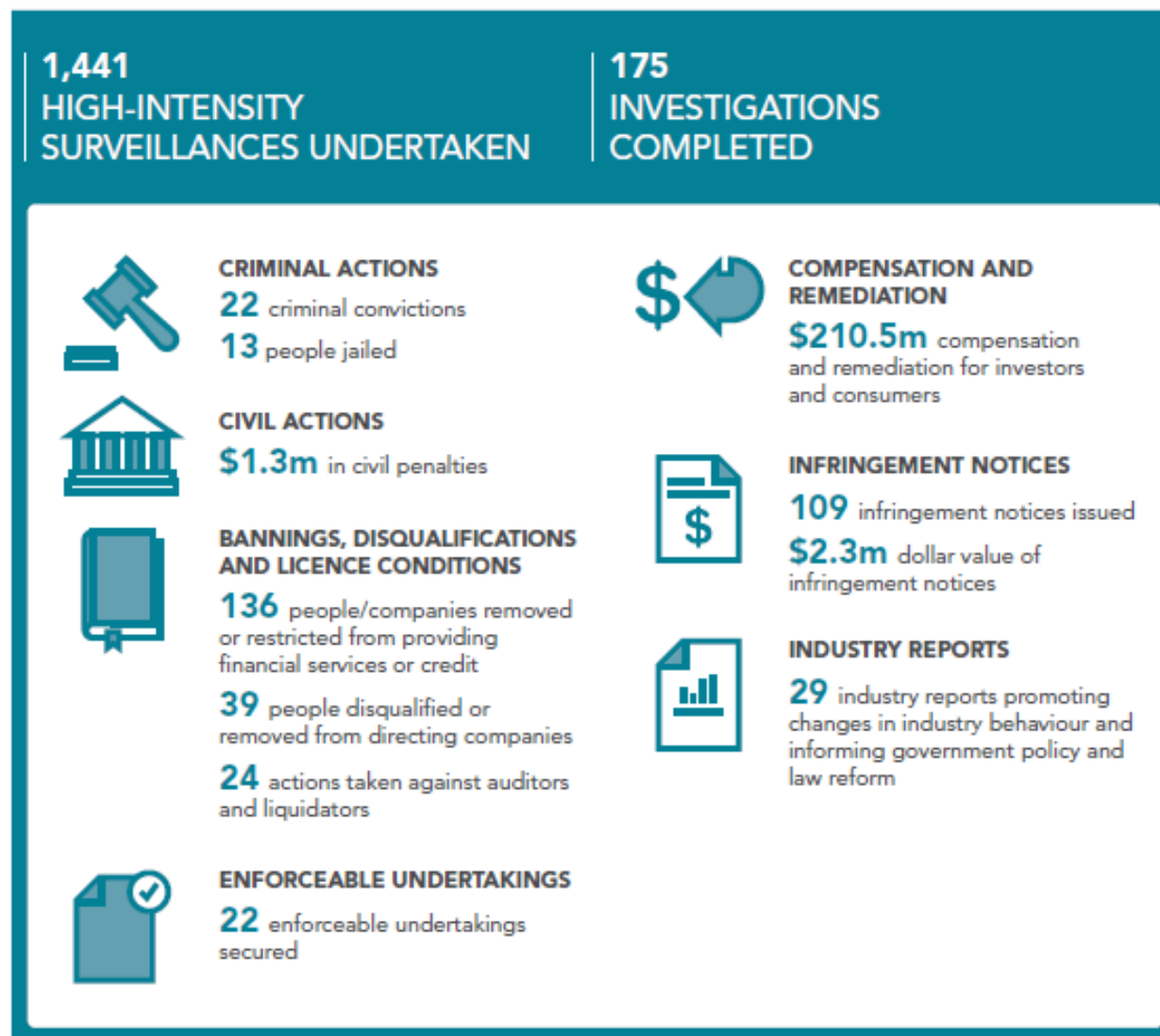
INTRODUCTION

- ▶ Two parts to the discussion
 - Litigation trends and highlights
 - Investigation trends and future focus

PART 1

ASIC Litigation 2016 – trends and highlights

ASIC surveillance and enforcement outcomes, 2015–16



ASIC litigation 2016

Civil Litigation

- ▶ Litigation concluded since 1 January 2016
 - 36 civil litigation outcomes, including:
 - FCA 29 (1 full court, 1 major CCC decision)
 - SCV 3 (limited contribution – AsJ decisions only)
 - SCQ 4 (FS / Managed Investments)
 - Compare – 43 outcomes in 2014–2015

ASIC civil litigation highlights – 2016

- ▶ Full Court of Federal Court
 - *Lewski & Ors v ASIC* [2016] FCAFC 96 (Greenwood, Middleton & Foster JJ)

- ▶ Federal Court
 - *ASIC v Channic Pty Ltd* [2016] FCA 1174 (Greenwood J)
 - *ASIC v Cassimatis (No 8)* [2016] FCA 1023 (Edelman J)
 - *Lock v ASIC* (2016) ACSR 318 (Gleeson J)

ASIC litigation 2016

- ▶ Lewski (Directors duties and MIS, late July 2016)
 - Appeal from *ASIC v APCHL* (2014) 103 ACSR 1
 - Facts
 - Australian Property Custodian (APC) was the RE of an MIS
 - In mid-2006 the board of APC resolved to amend the APC constitution so that fees would be paid to APC in circumstances including the listing of the trust
 - In mid-2007 the trust was listed and substantial sums became payable to Lewski and others

ASIC litigation 2016

▶ Lewski (Cont...)

◦ Issues

- The APC constitution prohibited amendments which benefited APC. Therefore:
 - Did the Board have the power to pass the resolutions?
 - If not, did the passing of the resolutions amount to a contravention of the directors duties (601FD) and contravene the related party transaction provisions?
 - Did it matter that at the time, the Director's honestly believed that the amendment to pay the listing fee was valid?

ASIC litigation 2016

▶ Lewski (Cont...)

- Findings of the trial judge (Murphy J) included
 - The amendment to the constitution was invalid
 - The resolution to lodge the amended constitution involved a contravention of s601FD
 - The payment of a “listing fee” contravened the requirements in respect of related party transactions by a responsible entity
- Penalties imposed by trial judge
 - Max PP of \$200,000 with varying disqualifications

ASIC litigation 2016

▶ Lewski (Cont...)

- Issues on the appeal included
 - Major focus on the director's unchallenged evidence (accepted by the TJ) that they believed at the time that the amendment was valid
 - This evidence was supported by other evidence such as legal advice relied upon by the directors
- ASIC's cross appeal
 - Penalties inadequate except for the fifth appellant

ASIC litigation 2016

▶ Lewski (Cont...)

◦ Outcome of appeal

- *“the trial judge failed to appreciate that the focus should have been upon the alleged wrongful conduct that occurred at the time of each alleged contravention. The directors were entitled to act in accordance with the constitution which they honestly believed existed, and make decisions accordingly...”*
[341 et al]
- Appeal upheld and ASIC’s cross appeal dismissed

ASIC litigation 2016

- ▶ Channic (Consumer Credit Code, late September 2016)
 - Facts
 - Car loans being offered in Cairns to indigenous clients who were either welfare recipients, former bankrupts, persons with bad credit history etc
 - Loans were uncommercial, e.g
 - Interest rates of 48% per annum
 - Consent to repossession in the event of default and remain liable for any outstanding loan amount
 - Cars purchased were worth less than the loans (i.e., cars were over-priced)

ASIC litigation 2016

▶ Channic (Cont...)

◦ Issues included

- Did the conduct alleged constitute breaches of the Consumer Credit Code obligations to
 - Ascertain client's objectives
 - Understand and verify client's financial situation
 - Ensure the credit offered is of a type which is suitable
- Did the conduct of the defendants contravene the unconscionable conduct consumer protection provisions of the ASIC Act

ASIC litigation 2016

▶ Channic (Cont...)

- The real value of this decision (in circumstances where the Court, unsurprisingly, found in favor of ASIC) is
 - The detailed consideration it gives to the CCC regime, its structure and application
 - The consideration given to the issue of when a person should be considered to be “involved” in a contravention of the CCC (s5):
 - Court applied the accepted authorities used in the context of the *Corporations Act* (e.g., *Yorke v Lucas*) and concluded [at 1821]...

ASIC litigation 2016

- ▶ Cassimatis (Storm CPP proceeding, late Aug 2016)
 - Facts
 - Storm operated a successful financial planning business in Townsville
 - Sold its clients the “storm model” which involved investors “double gearing” by
 - Borrowing against their homes
 - Taking a margin loan
 - Using funds from the 2 loans to invest in index funds and establishing a cash reserve to pay storms fees
 - Subject to market movement place further “step” investments

ASIC litigation 2016

▶ Cassimatis (Cont...)

◦ Facts Cont..

- GFC happened, the client's investments tanked and storm was liquidated

◦ ASIC's case

- Alleged breaches of 180(1) directors duty of "care and diligence"
- **But** (curiously) framed case so that they had to prove breaches by Storm of their FS law obligations including appropriateness of advice (945(1)(c)) in order to prove the 180 breach

ASIC litigation 2016

▶ Cassimatis (Cont...)

◦ Mr and Mrs Cassimatis' case

- the storm model was viable and the contraventions were not reasonably foreseeable for them as directors given they had no interaction with the individual clients
- The storm model had been reviewed by many accountants, lawyers, ASIC etc, none of whom expressed concern
- Only reason the storm model failed was because of the “black swan” event of the GFC
- However, if did contravene the s1317S excuse provision applied

ASIC litigation 2016

▶ Cassimatis (Cont...)

◦ Court found

- The way ASIC framed its case set for itself a higher bar
- Whilst it is not necessary to prove a breach by Storm to make out the DD case, not every breach by a corporation will necessarily constitute a breach by its directors
- ASIC proved its case in respect of 11 clients who
 - Were close to retirement
 - Had little or limited income and few assets
 - Had little hope of rebuilding in the event of a loss

ASIC litigation 2016

▶ Cassimatis (Cont...)

◦ What of the s1317S excuse provision?

- Extensive consideration of the history of the provision, including its first enactment in UK in 1890s
- Court accepted that Mr and Mrs Cassimatis
 - Acted honestly and genuinely believed there was little danger of the model failing
 - Had they been advised to do so, would have varied the model
 - There were many investors for whom no contravention was proved and assistance was given to many clients
- Whilst these provide a significant argument for relief...[824]

ASIC litigation 2016

- ▶ Lock (Storm “class action”, February 2016)
 - Facts:
 - Per Cassimatis, Storm was an FS company which between ‘94 and ‘04 recommended the “storm model” (high fees / highly leveraged)
 - GFC resulted in storm being placed into liquidation on 26 March 2009
 - Allegations made against ASIC:
 - ASIC knew about the “storm model” from a “surveillance” in 2005 and a prospectus in 2007
 - ASIC failed to act to prevent storm from operating the “storm model” at these times

ASIC litigation 2016

▶ Lock (Cont...)

◦ Issue

- Did the plaintiffs' case disclose an arguable cause of action (i.e., could ASIC's failure to act constitute negligence or misfeasance in public office)?

◦ Findings

- Re misfeasance, the failure to act was not a misuse or abuse of public power for the purpose of the tort
- Re negligence:
 - no duty of the type alleged (i.e., to prevent storm operating) existed
 - P'ffs knew they were taking a risk in investing and acting in their own self-interest in taking advice from Storm

ASIC litigation 2016

▶ Lock (Cont...)

◦ Conclusion

- No causative link between the any conduct complained of and any loss suffered
- The SOC was so deficient that it was struck out in its entirety with costs

ASIC litigation 2016

▶ Litigation trends

- Have *Centro* (Aug 2011) and *Fortescue* (Oct 2012) had a lasting impact on ASIC?
 - The profession's reaction to *Centro* has not eventuated (at least not yet!)
 - Instead – appears ASIC may now be reluctant to bring CPP cases unless significant ban or PP are assured
 - Absence of big-scalp market disclosure litigation
 - Has the loss in the High Court impacted ASIC's appetite for such cases?

ASIC litigation 2016

- ▶ Litigation trends (cont)
 - Are class actions working as a consumer protection tool?
 - Compare cases where ASIC has acted as advocate for the investor (e.g., Westpoint and Storm)
 - ASIC has generally achieved good outcomes in this space
 - Compare the calls for a Royal Commission
 - The evidence of ineffective regulation usually arises in the context of one-off contraventions where there is no “class”

PART 2

Investigation trends and future focus

ASIC Annual Report 2015–2016

- ▶ Annual report provided to Govt on 14 October 2016
 - Capability review in late 2015 – 34 recommendations, most to be implemented
 - Numerous inquiries, e.g.
 - Penalties for white-collar crime (resulting in a further review of ASIC’s enforcement regime, including penalties, in 2017)
 - Scrutiny of financial advice (“...more could be done to increase competence and professional standards”)

ASIC Annual Report 2015 –2016

▶ Also tells us

- The number of investigations which have been commenced and either
 - Resulted in litigation or
 - A non-litigious outcome

Enforcement

Investigations

| | | | | |
|--------------------------|----|----|-----|----|
| Investigations commenced | 93 | 77 | 97 | 81 |
| Investigations completed | 79 | 88 | 113 | 92 |

Criminal actions

| | | | | |
|--|---------|----------|---------|----------|
| Criminal litigation completed ⁵ | 7 | 7 | 16 | 14 |
| Criminal litigation completed successfully ⁵ | 100% | 86% | 94% | 86% |
| New criminal litigation commenced ⁵ | 13 | 11 | 13 | 8 |
| Number of people convicted | 7 | 6 | 15 | 12 |
| Custodial sentences (including fully suspended) ⁶ | 3 | 5 | 13 | 11 |
| Non-custodial sentences/fines | 4 | 1 | 2 | 1 |
| Total dollar value of fines | \$8,500 | \$10,000 | \$5,000 | \$75,000 |

Civil actions

| | | | | |
|---|-------------|---------------------------|-------------|-----------|
| Civil litigation completed | 36 | 43 | 12 | 39 |
| Civil litigation completed successfully | 94% | 86% | 100% | 100% |
| New civil litigation commenced | 44 | 20 | 31 | 37 |
| Total dollar value of civil penalties | \$1,275,000 | \$18,975,000 ⁷ | \$1,500,000 | \$677,500 |

Administrative actions⁸

| | | | | |
|--|----|----|----|----|
| Administrative actions completed | 74 | 64 | 67 | 58 |
| New administrative actions commenced | 51 | 74 | 60 | 59 |
| People/companies banned from financial services ⁹ | 81 | 53 | 63 | 50 |
| People/companies banned from credit services | 55 | 39 | 46 | 38 |

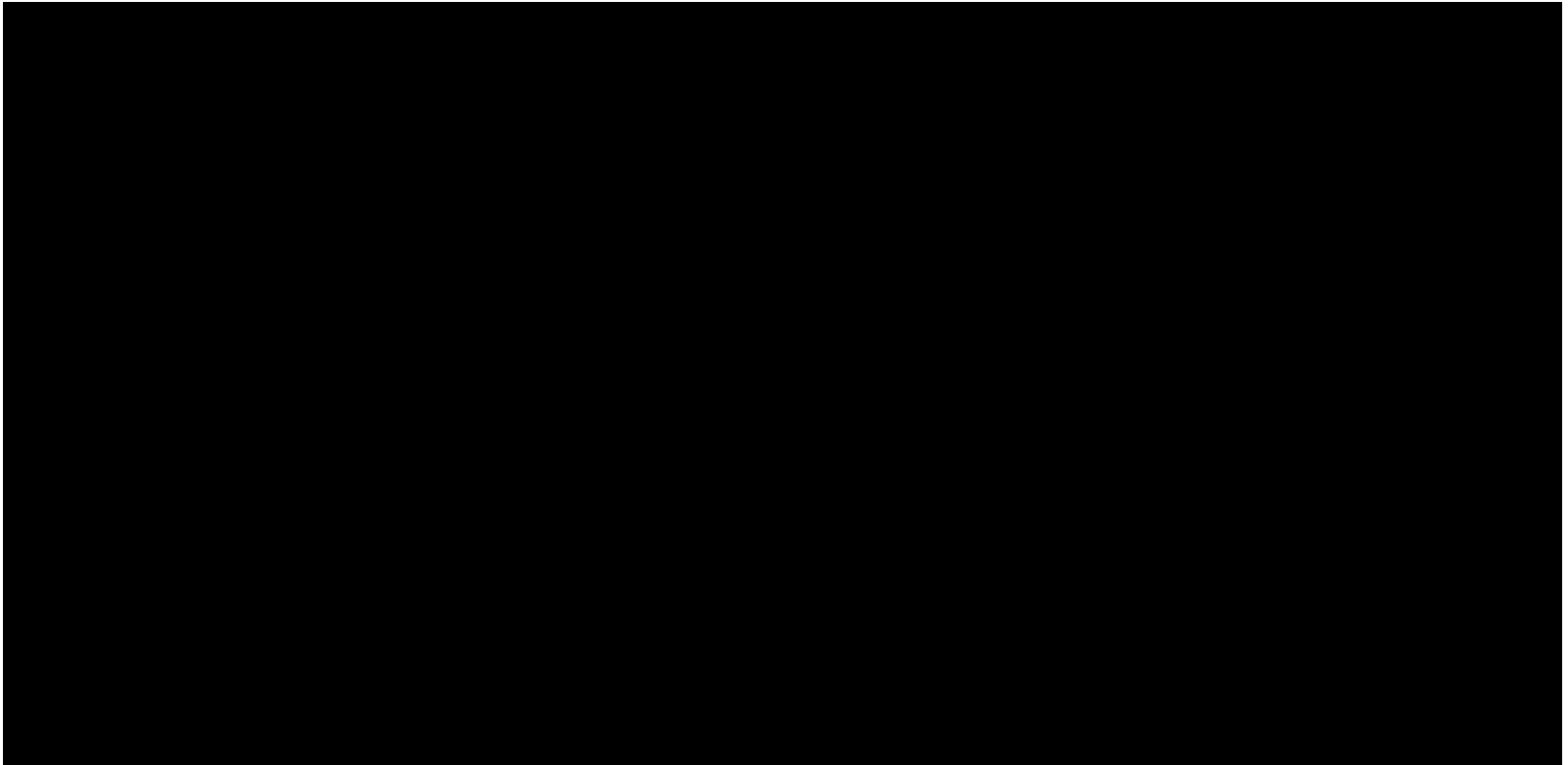
Non-litigious outcomes

| Outcome | 2015-16 | 2014-15 | 2013-14 | 2012-13 |
|---|-------------------------------|----------------|-----------------|-----------------|
| Enforceable undertakings | | | | |
| Enforceable undertakings accepted | 13 | 10 | 18 | 12 |
| Infringement notices | | | | |
| Number of infringement notices issued – ASIC Act ¹⁰ | 9 | 32 | 16 | 3 |
| Dollar value of infringement notices – ASIC Act ¹⁰ | \$93,600 | \$319,400 | \$163,200 | \$19,800 |
| Number of infringement notices issued – National Credit Act ¹⁰ | 87 ¹¹ | 38 | 4 | 5 |
| Dollar value of infringement notices – National Credit Act ¹⁰ | \$1,130,500 ¹¹ | \$391,000 | \$77,000 | \$5,500 |
| Compensation | | | | |
| Compensation or remediation | \$210.5 million ¹² | \$35.2 million | \$172.6 million | \$203.9 million |

Where to next?

- ▶ ASIC's corporate plan
 - What does ASIC consider to be the major issues for 2016–2017

ASIC “Corporate Plan” 2016 – 2017



What the corporate plan tells us

- ▶ ASIC has heard and understood the outcomes of the inquiries it has been subjected to
 - A large focus on the provision of financial services and consumer credit, including
 - Culture within FS providers
 - FS advice being offered that is fair and competent
 - Inappropriate or “unfair” products being “called out”
 - Consistent with the observations made earlier, no mention of a focus on the types of issues that led to the *Centro* and *Fortescue* type litigation

ASIC CASE UPDATE

Questions?