Australian Government, Increasing Transparency of the Beneficial Ownership of Companies, Consultation Paper, February 2017

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Thank you for the opportunity of providing comment on the above mentioned consultation paper.

Background

There are significant obstacles in identifying the beneficial owners of companies largely due to the system of nominee shareholdings. Although the original rationale of nominees was to facilitate the administration of assets, the nominee shareholding system has evolved so that it is now an "essential part of the infrastructure of the world's capital and financial markets": see David Chaikin, 'Nominee shareholders: Legal, commercial and risks aspects', (2005) 18 *Australian Journal of Corporate Law 288* (**Attachment A**). Since there is no prospect of abolition of nominee shareholdings – which would plainly be a foolish endeavour – identifying beneficial ownership will be problematical whatever proposals are enacted by the Australian government.

There are numerous studies documenting the abuse of corporate structures in relation to corruption, tax evasion, money laundering, fraud and phoenix trading. It is widely accepted that beneficial ownership information is critical to law enforcement and the tax authorities, but this begs the question whether a new regulatory regime which requires "adequate, accurate and timely information on the beneficial ownership and control" of companies and legal arrangements, such as trusts (FATF Recommendations 24 and 25), would secure this objective. A related question is how will an increase in transparency of beneficial ownership deter criminals or tax evaders from using companies?

A new requirement of disclosure of beneficial ownership, will make it more 'difficult' for criminals to use corporations, but this is unlikely to offset the significant advantages of using a corporation, coupled with the ease of incorporation and relative low costs of establishment and maintenance. In these circumstances, any new regulation to improve the transparency of beneficial ownership of companies is likely to have only a modest effect on criminal misuse of corporations; assuming criminals are rational actors, they will take steps to evade or avoid any beneficial ownership transparency requirement. A counterfactual case is that of the Panama Papers where the intermediaries of suspected criminals and tax evaders disclosed to a Panamanian law firm/corporate services provider the beneficial ownership of thousands of offshore corporations.

As far as government policy is concerned, the major justification for enacting enhanced transparency of beneficial ownership of a proprietary/private company should be the Australian Government's commitment to the G20 and the Financial Action Task Force (FATF). If this is the case, then the regulatory policy that is adopted by Australia should comply with the minimum requirements of the global standards. Whether Australia should 'gold plate' those standards, as the United Kingdom government has done in relation to its creation of a central corporate registry of persons of 'significant control', is perhaps the major policy question that will need to be addressed in this consultation.

In relation to the issues raised in the consultation paper, I make the following observations.

Scope of companies subject to a new transparency ownership requirement

Listed companies should be excluded from any new requirement to obtain beneficial ownership information and/or establish a new beneficial ownership register since this would be an unnecessary duplication of the existing obligations on listed companies. This is consistent with the FATF's global standards on anti-money laundering (AML) and counter-terrorist financing (CTF) and the UK legislation on transparency of beneficial ownership of private companies (see *Small Business*, *Enterprise & Employment Act 2015* amending the *Companies Act 2006* by inserting a new Part 24). Any attempt to amend the existing requirements on listed companies, for example by imposing a new obligation on listed companies to obtain beneficial ownership information (rather than imposing the obligation on the beneficial owner of a listed company as is the current law in Australia, UK and elsewhere) would make Australian corporate securities law unduly burdensome and uncompetitive.

Tests for beneficial ownership

If the government seeks to obtain a high level of compliance with any new legislation it should ensure that the tests for beneficial ownership disclosure are easily understood by the directors and owners of companies in Australia that would be subject to the new obligation.

The UK tests for disclosure of beneficial ownership of companies are somewhat complicated in that it is necessary to examine the legislation, regulations, statutory guidance and non-statutory guidance. The reason for such complexity is that legitimate businesses in the UK wished to have greater certainty in respect of their new obligations, given that a breach of their obligations would amount to a criminal offence.

It is highly likely that the vast number of criminals who misuse criminal structures will not be combing through a regulatory maze of tests to avoid compliance with any new beneficial ownership requirement; they will just evade their obligations. If this is the case, and given that there are relatively simple mechanisms to avoid complying with any new regulatory scheme, then the effect

of a complex test of beneficial ownership may be to impose additional regulatory costs without commensurate benefits.

Collection of beneficial ownership information

The UK legislation imposes an obligation on private companies to collect information on persons with significant influence (PSC), and a default obligation on PSCs to notify the company of their interests. This may be contrasted with the UK law (and the Australian law) in respect of listed companies, where the obligations are imposed only on beneficial owners. No explanation has been given as to why the obligations on private companies in the United Kingdom should be greater than listed companies in collecting beneficial ownership information. One possible explanation is that the UK adopted a more onerous regime because this was the only realistic method of quickly creating a central corporate registry of beneficial ownership.

Tracing Notices/Directions

Tracing notices/directions under the *Corporations Act 2001 (Cth)* have facilitated the statutory objective of a fully informed, efficient competitive market in the shares of listed companies. The reason for this success is that a secret beneficial owner will not be able to take control of a company through a takeover, unless it complies with a tracing notice.

On the other hand, the use of tracing notices to obtain beneficial ownership information has been of limited utility in unmasking secret beneficial owners of listed companies who hide behind foreign nominees: see *Australian Securities Commission v Bank Leumi Le Israel (Switzerland)* [1996] FCA 825; 69 FCR 531; 139 ALR 527; 14 ACLC 1576; 21 ACSR 474. The case law suggests that tracing notices will not be effective in identifying a secret beneficial owner who wishes to maintain anonymity even if this means the sale of its shares: see David Chaikin, 'Penetrating Foreign Nominees: A failure of strategic regulation', (2006) 19 *Australian Journal of Corporate Law* 141, and cases cited at pp 153-157 (**Attachment B**).

Even if the Australian courts were prepared to impose punitive sanctions (such as confiscating shares) on unidentified beneficial owners who refuse to consent to their nominees disclosing their identity under a tracing notice, this would have little, if any, deterrent effect on 'shell companies', since by definition such companies have no valuable asset within the jurisdiction.

The above considerations do not mean that tracing powers have no policy importance. It would be useful to make the existing tracing powers under the *Corporations Act* 2001 (Cth), which can be utilised by the Australian Securities and Investment Commission and listed companies, available to proprietary companies. An extension of the law would allow the Australian Government to argue in international fora, such as in respect of the FATF, that it has increased its investigatory capacity to obtain beneficial ownership information.

Should there be a central registry of beneficial ownership?

Under the existing FATF global standards, there is no present requirement for countries to create a central registry of beneficial ownership. Whereas the UK has adopted a regime requiring a central register of beneficial ownership, under the proposed Singaporean legislation companies will be required to maintain a register of beneficial ownership but no central registry will be created at this stage.

One of the advantages of a central registry is that law enforcement will be able to apply 'Big Data' techniques to beneficial ownership and other corporate information. According to Anthony Wong: "Big data allow us to combine, interrogate, mine and analyse large structured or unstructured, multiple datasets with ease where the sum of these datasets is more valuable than its parts, allowing us to identify correlations that were not easily done previously": see Antony Wong, 'Big Data Fuels Digital Disruption and Innovation: But Who Owns the Data', chapter 2 in David Chaikin and Derwent Coshott (forthcoming) (eds), *Digital Disruption: Impact on Business Models, Regulation and Financial Crime*, Australian Scholarly Publishing, 2017, pp 19-20). This is illustrated by a recent study by Global Witness which examined the UK beneficial ownership data set in November 2016 and found numerous inconsistencies as well as interesting investigatory leads: see Robert Palmer and Sam Leon, *What Does the UK Beneficial Ownership Data Show Us*, Global Witness Blog, 22 November 2016.

Operation of a central registry

Any proposal to privatise a central registry of beneficial ownership (and any other register operated by ASIC) would result in increased costs to the general public in accessing information on the register. This would undermine the basic goal of transparency by making it more costly to access information that is being collected under statutory enactment.

Australia is notorious in its policy of imposing high charges and fees to access corporate information. For more than 20 years it has been far cheaper to investigate foreign incorporated companies (eg companies registered in the cantons of Switzerland) than Australian companies, since many foreign countries do not charge fees on electronically accessing information on their corporate registries.

If Australia continues to charge fees for accessing corporate information, the potential benefits of a central registry will be more limited than is the case, say in the United Kingdom, which permits the entire PSC data set to be downloaded by the public at no cost.

Verification of beneficial ownership information

One of the most difficult challenges in ensuring compliance with any new law is verifying beneficial ownership information which is supplied to the company. Under chapter 4 of the *Anti-Money Laundering and Counter-Terrorism Financial*

Rules Instrument 2007 (No.1) (Cth) reporting entities are obliged to take 'reasonable measures' to verify certain information concerning the beneficial owner. For larger reporting institutions, such as banks, there is an incentive to comply with a verification obligation because of the penalties that may be imposed under Australian law but also under foreign laws, such as under the United States AML/CTF laws and the Foreign Account Tax Compliance Act (FACTA). Larger reporting entities rely on economies of scale to obtain benefits from spending resources on verification, while smaller reporting entities do not have adequate resources to verify beneficial ownership information.

It has sometimes been asserted that the corporate registry should have an obligation to vet and verify information that is supplied to it, for example that ASIC should have an obligation to verify beneficial ownership information in relation to proprietary companies. This argument ignores the costs which would be incurred by ASIC if it had to vet the millions of documents that it receives each year from companies.

Given that more than 70% of new companies are registered through a corporate services provider (CSP), it would make sense if an obligation was imposed on CSPs to verify the accuracy of beneficial ownership information. This new obligation on CSPs should be part of a new regime whereby CSPs were made reporting entities under the *Anti-Money Laundering and Counter-Terrorism Financing Act 2006 (Cth).*

A Modest alternative proposal(s)

If the Australian government decides that comprehensive legislative approach to beneficial ownership transparency is preferable, it could adopt the UK legislative framework with some slight modifications. A central corporate registry of beneficial ownership information would be an essential plank of the new system.

If the Australian government is concerned about the increased costs on small businesses which may result from a comprehensive legislative regime, it may consider a more modest proposal as follows:

> The transparency obligation should be imposed only on a limited class of persons, for example, new companies upon registration. A new company is in the best position to know the identity and details of its beneficial owners. Given that approximately 200,000 new companies are registered with ASIC each year, the burden of compliance would be much less than imposing the obligation on 2.4 million registered companies. The other advantage of targeting new companies is that such companies are more likely to be used in phoenix trading, which is a serious problem for businesses and the tax authorities.
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> The transparency obligation should be also be imposed on the transferees of shares of existing companies. That is, where a member's shares are transferred to a third party, that party would not only have an obligation to disclose whether those shares are beneficially held or not (as is the

current law), but also identify who is its nominator (if applicable) and the identity of the ultimate beneficial owner (if known). This information would be of some value to law enforcement and tax authorities which could use their investigatory powers to make inquiries of the nominator and/or the UBO.

Companies should be given the power to trace beneficial shareholders if they desired to utilise such powers.

The above approach is admittedly gradualist, not comprehensive and in the modern parlance full of loopholes, in that criminals will be able to misuse existing companies. However, where criminals seek to use a new company to carry out a crime or launder monies, there will be obligations of disclosure.

In relation to the vast majority of companies which are law abiding, it might be useful to encourage such companies to voluntarily supply beneficial ownership information as part of their annual return. Many proprietary companies might decide that it is in their best interests to volunteer such information as part of their corporate social responsibilities.

END OF SUBMISSION

Nominee shareholders: Legal, commercial and risk aspects

*Dr David A Chaikin**

It has been settled law since the nineteenth century that the shares of a registered company may be held under a nominee arrangement. The original justification for nominee shareholding was that it provided an efficient mechanism for the administration of assets held on behalf of another person, and that it secured the financial privacy of persons who did not wish to appear on the company registry. The role of nominee arrangements has expanded beyond its original rationale to become an essential part of the infrastructure of the world's capital and financial markets. The demand for efficient systems for registering, holding, transferring and clearing securities transactions has resulted in the widespread use of nominee arrangements. The commercial use of nominee shareholdings is so important that any proposal to prohibit the use of nominees would be costly and unworkable. There is nothing illegal or unethical in using nominees as part of a private or commercial arrangement. In the case of a nominee, there is no common law principle or doctrine of equity requiring the identification of the ultimate beneficial owner of securities. The corporate law justification for requiring disclosure of substantial holdings of listed companies does not apply in the case of proprietary or private companies. Any proposal to extend the substantial shareholder disclosure regime to proprietary companies requires separate and substantial justification, which has not yet been forthcoming. There is an argument that the financial privacy justification for nominee shareholdings should be discarded because nominees may be used for illicit purposes, particularly money laundering. This argument ignores the legitimate demands for financial privacy. It is not supported by empirical evidence of significant misuse of nominees. It also fails to appreciate that nominee shareholdings are only one of many devices that are open to those who wish to conceal their interests in shares for illicit reasons.

1 Introduction

It has been settled law since the nineteenth century that the shares of a registered company may be held under a nominee arrangement. The original justification for nominee shareholding was that it provided an efficient mechanism for the administration of assets held on behalf of another person and that it secured the financial privacy of persons who did not wish to appear on the company registry. The demand for nominee shareholdings has increased as a consequence of the development and internationalisation of capital markets. Today nominee arrangements are an essential feature of the system for registering, holding, transferring and clearing securities transactions.

The main criticism of nominee shareholding is that it may facilitate hidden

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changes in corporate control, especially in relation to takeovers.[1] The concern of company lawyers with the potential misuse of nominees has focused on the lack of transparency of significant shareholdings in listed companies. This has led to the enactment of laws requiring disclosure of persons who have a substantial interest in shares. These laws only apply to a limited class of companies, usually shares that are traded in the public securities markets.

The use of nominee shareholdings to conceal financial crimes such as corruption and money laundering has resulted in the questioning of the financial privacy rationale of nominee shareholdings.[2] Criticism of nominee shareholdings is often made without an understanding of the legitimate demands for financial privacy which may also be important for the efficiency of business enterprises. It also ignores the fact that nominee shareholding arrangements are only one of many devices that are open to those who wish to conceal their interests in shares for illicit reasons. The widespread use of nominee shareholdings means that any proposal to require increased disclosure should be carefully designed so as not to impose onerous burdens on business and markets.

2 Historical overview of nominee shareholders

Anglo-American jurisprudence has recognised for a long time that the shares of a company may be held under a nominee arrangement. In 1844 when registered companies were first introduced in England,[3] there was a requirement of a minimum number of members (or shareholders) whose identity was disclosed on the corporate registry. There was no requirement to disclose the beneficial ownership of shares. The concern of the English legislature at this time was with the legal liability of members for calls on partly paid shares issued in their names.[4] Since the registered shareholder was liable for the calls, it did not matter whether those shares were held under a nominee arrangement.

In 1897 in the important case of *Salomon v Salomon*[5] the House of Lords held that the minimum number of members of a company could be satisfied even if the interests of some shareholders were small, or indeed nominal. Lord Herschell observed[6] that although a 'one-man company' may not have been in contemplation by parliament when bestowing limited liability on registered companies,[7] there was nothing in the companies legislation requiring the seven registered shareholders to be beneficially entitled to their shares.

1 See Company Law Advisory Committee Report to the Standing Committee of Attorneys-General, *Substantial Shareholdings and Takeovers*, Chairman R M Eggleston, Commonwealth Government Printing Office, Canberra, December 1969.

2 'With respect to publicly traded shares, nominees . . . are commonly and legitimately used to facilitate the clearance and settlement of trades. The rationale for using nominees in other contexts, however, is less persuasive and may be subject to abuse.' : see OECD, *Behind the Corporate Veil: Using Corporate Entities for Illicit Purpose*, OECD, Paris, 2001, p 31.

3 Joint Stock Companies Registration and Regulation Act 1844 (7 & 8 Victoria c 110).

4 See *Report of the Committee on Company Law Amendment*, Cmnd 6659, HMSO, London, 1945, par 77-9 (Cohen Committee).

5 *Salomon v Salomon & Co* [1897] AC 22.

6 Ibid, at 43–4.

7 The members of a registered company were liable for its debts until the Limited Liability Act 1855 (18 & 19 Vict c 133).

The idea that company law was not concerned with discovering the beneficial ownership of shares was reiterated by a number of principles. In countries which followed the British model of shareholder membership, such as Australia,[8] there was a statutory enactment which provided that no notice of any trust, whether express, implied or constructive, may be entered on the register of members.[9] The purpose of this requirement was to protect the company from legal action by persons who were not registered as shareholders, such as beneficiaries of a trust where shares were held in the name of a trustee. The company was not required to adjudicate on disputes that may arise between registered shareholders and third parties in relation to the shares of the company. The virtue of this requirement was that it facilitated a free market in shares. It also reinforced the foundation principle of the separate legal personality and identity of the company.

Under the British model of share ownership, there was a freedom to transfer shares without disclosing beneficial or equitable interests. A registered shareholder was free to transfer or assign any equitable interest in his or her shares without disclosing this to the company or to the public generally. This allowed a shareholder to deal with interests in shares through an equitable assignment.

Until the rapid development of public capital markets in the latter half of the twentieth century, company law in most countries was not concerned with the identity of the ultimate beneficial owner of shares.[10] It was the demands of the market for information about the persons who exercised control over publicly listed companies which led to the enactment of legislation requiring the disclosure of the beneficial ownership of shares.

3 Substantial shareholder disclosure law in Australia

The historical reasons for enacting a shareholding disclosure regime relate to matters of concern to company lawyers, and have little, if anything, to do with matters relating to financial crime. The classic justification for a law requiring public disclosure of substantial beneficial interests is that it facilitates the creation and maintenance of a fully informed, efficient and competitive market in shares.[11] An equally important justification for shareholder disclosure is the maintenance of public confidence in the securities market.[12] In most countries the disclosure obligation applies to a limited class of companies 'whose membership is likely to be a matter of interest to investors, potential investors

8 Most of the Australian colonies passed legislation based on the model of the English Companies Act 1862 (25 and 26 Victoria).

9 See Companies Act 1862 s 101, now Companies Act s 360 (England). For the current Australian provision limiting the placing of trusts on the corporate registry, see Corporations Act 2001 (Cth) s 1072E (10).

10 This article does not examine tax and the general fiscal law, which have developed far reaching provisions, in many instances allowing full penetration of nominee registration.

11 See *Australian Securities Commission v Bank Leumi Le-Israel (Switzerland)* (1996) 69 FCR 531 at 535 per Lehane J; 139 ALR 527. See also Corporations Act s 602(a).

12 Securities Commission of New Zealand, *Nominee Shareholdings in Public Companies: A Review of the Law and Practice, with a Proposal for Reform*, Government Printing Office, Wellington, 1981, pp 133, 146. See also D Chaikin, 'Cracking the Nominee in New Zealand' (1982) 8 *Commonwealth Law Bulletin* 814–20.

and the public at large'.[13] For example, in Australia the statutory regime for disclosure applies to 'substantial holdings' in the securities of listed companies and managed investment schemes.

The shareholder disclosure obligation was first enacted in Australia in 1972 and has been revised on a number of occasions to deal with unintended loopholes. As a consequence the shareholder disclosure law is detailed, complex and often difficult to interpret in the increasingly sophisticated and rapidly changing capital markets.[14] There are considerable compliance costs associated with a comprehensive substantial shareholder disclosure law. Under s 9 of the Corporations Act 2001 (Cth) the disclosure obligation arises when a person has a substantial holding, that is, when a person and their associates have a relevant interest in shares which carry 5% or more of votes.

Of critical importance is the definition of 'relevant interest' which is set out in ss 608 and 609 of the Act. The basic rule is that there are three circumstances where a person has a relevant interest in securities: '(a) [if they] are the holder of securities; (b) [if they] have the power to exercise, or control the exercise of, a right to vote attached to the securities; or (c) [if they] have the power to dispose of, or control the exercise of a power to dispose of, the securities.' The Corporations Act extends the basic rule to cover a range of situations in which control of securities may be exercised. For example, a person has a relevant interest in any securities held by a company where that person's voting power is above 20% in relation to that company.[15] A person also has a relevant interest in any securities of a company which that person controls.[16] A person is deemed to control a company if that person has the 'capacity to determine the outcome of decisions' of that company.[17] This means that a person who exercises control through a chain of companies will be subject to the disclosure obligation.

The definition of relevant interests focuses on a person's voting power which is measured by a formula set out in s 610. In calculating whether the 5% threshold has been reached, the relevant interests of the person and their 'associates' are added together. The courts and the Takeover Panel have adopted a liberal interpretation of the concept of associates, which is dealt with in ss 10 to 17 of the Act. As a practical matter, it may be difficult to determine whether a person who is resident overseas is an associate. The Act also lists situations in which a 'relevant interest' is to be disregarded. The justification for excluding certain relevant interest from the disclosure obligation is that these interests are generally not held for the purpose of exercising or obtaining control of the company. For example, one of these exceptions is a nominee that holds securities as a bare trustee.[18]

The law on substantial holding disclosure sets out the requirements as to the

13 *Report of the Company Law Committee*, Cmnd, 1749, HMSO, London, June 1962, para 143 (Jenkins Report).

14 For an outline of the history and context of the Australian law, see A G Hartnell, 'Relevant Interest — "Control" in the 1980s' (1988) *C&SLJ* 169.

15 Corporations Act s 608(3)(a).

16 Corporations Act s 608(3)(b).

17 Corporations Act s 608(4).

18 Corporations Act s 609(2).

information and documentation that must be disclosed.[19] Notification must be given of the details of the relevant interests of the person and their associates, any relevant agreement which has contributed to the situation giving rise to the relevant interest, and the documentation of the relevant agreement. ASIC considers that the substantial holder disclosure practices of many companies have not been satisfactory[20] and this has led ASIC to revise its policy on substantial shareholding disclosure.[21]

Disclosure of the substantial shareholding must be made to the company and the relevant exchange within two business days after the holder of a substantial interest becomes 'aware of the information'.[22] This requirement of actual knowledge is problematical in the case of companies because they are artificial entities and can only have knowledge through human agents. The issue of how a company has knowledge is dealt with by applying rules of attribution[23] but this is not always satisfactory where the identifiable agents of a company claim to be ignorant of who gave them instructions to purchase the shares.[24] A breach of the substantial holder law may give rise to a compensatory claim for loss and damages under s 671C. The court has wide ranging powers under s 1325 of the Act to deal with a contravention of the substantial holder law. The Takeover Panel has the power to make a declaration of unacceptable circumstances where there has been a contravention.

4 Beneficial shareholdings disclosure and proprietary companies

Unlisted companies, such as proprietary companies, are not required to comply with the substantial shareholder disclosure law. The 'investment protection' and 'market confidence' justifications for laws requiring substantial shareholder disclosure have no application in the case of proprietary companies. However, the justification for extending shareholder disclosure to proprietary companies may be based on notions of protecting parties which have existing or potential contractual relationships with the company, such as creditors or employees. There is also a public interest in increasing shareholder disclosure so as to detect and prevent the illicit use of nominee shareholdings or other corporate secrecy vehicles.[25]

Australian law provides for a limited degree of disclosure of share

19 Corporations Act ss 671B(3)–(5).

20 See, eg, *New Ashwick Pty Ltd v Wesfarmers Ltd* (2000) 35 ACSR 263; 18 ACLC 742. See, generally, G Costa, 'ASIC enforces more decent disclosure', *Sydney Morning Herald*, 19 November 2004.

21 ASIC Policy Statement 159, *Takeovers, compulsory acquisitions and substantial holding notices*, paras 159.270–271, November 2004.

22 Corporations Act s 671B(6).

23 See, eg, *Meridian Global Funds Management Asia Ltd v Securities Commission* [1995] 2 AC 500; [1995] 3 NZLR 7 (Privy Council).

24 See, eg, *ASIC v Merkin Investments Pty Ltd* (2001) 38 ACSR 648; 19 ACLC 1481, where the court refused to attribute the knowledge of the unknown client to its principal in circumstances where there was no evidence as to 'the chain of command or the precise relationship involved'.

25 OECD, above n 2, p 14 ff.

ownership in the case of unlisted companies. Since 2003 a proprietary company has been required to indicate in its share register whether any shares held by a member are held beneficially.[26] In determining[27] whether a member holds shares beneficially or non-beneficially, the company is to have regard only to notices given to it by transferees,[28] disclosures of relevant interests under the tracing provisions,[29] or information supplied by ASIC.[30] A proprietary company is also required to notify ASIC of any change in its registry of members, including particulars required to be kept concerning a member's beneficial shareholding.[31] If a proprietary company has more than 20 members, the ASIC notification requirement only applies to changes in respect of the top 20 members, or persons who will become a top 20 member after the change.[32]

Registered shareholders are not affected by the notice requirements unless they become new members. The obligation to provide notice to the company of non-beneficial share ownership is imposed on a very limited class of persons, namely a transferee who holds non-beneficially particular shares. Upon registration of a transfer of shares,[33] a transferee must give notice to the company showing that the shares are held non-beneficially. The Corporations Act provides for relevant presumptions about beneficial ownership, for the purpose of complying with the share transfer requirements. For example, a person who 'holds shares as trustee for, as nominee for, or otherwise on behalf of or on account of, another person' is presumed to hold the shares non-beneficially.[34]

The longstanding rule that no notice of a trust may be entered on a register kept in Australia or be receivable by ASIC[35] has been modified by the new law requiring the disclosure of the existence of non-beneficial shareholding's interests. Furthermore, trustees, executors and administrators of an estate may be registered as owners of shares and their shares may be identified in the corporate register as being held in respect of a trust.[36] The risk that notice of a trust may affect the liability of a company is dealt with by the Act which provides that 'no liabilities are affected' by any such registration or notice and 'nothing so done (pursuant to the statutory provision) affects the body corporate concerned with notice of the trust'.[37]

The above mentioned statutory provisions have the advantage that they are not burdensome, are simple to understand and are relatively inexpensive. They have not resulted in the imposition of major compliance costs on proprietary companies or their registered shareholders. There is no retrospective operation of the provisions, so that registered shareholders are not required to make any

26 Corporations Act s 169(5A).
27 Corporations Act s 169(6).
28 Under s 1072H of the Corporations Act.
29 Under s 672B of the Corporations Act.
30 Under s 672C of the Corporations Act.
31 Corporations Act s 178A(1)(b)(viii). See Form 484.
32 Corporations Act ss 178A, 178B.
33 Corporations Act s 1072H.
34 Corporations Act s 1072H(8)(a).
35 Corporations Act s 1072E(10).
36 Corporations Act s 1072E.
37 Corporations Act s 1072E(10)(b) and (c).

additional disclosures. The notice obligation only arises when there is a transfer of shares. There is no requirement to disclose the identity of the underlying beneficial owners of proprietary companies

5 Legal concept of nominee shareholders

The legal duties of a nominee shareholder may be affected by the law of contract, the law of agency, the law of trust, and legislation. The classic nominee situation is when a nominee shareholder is the registered shareholder who holds the bare legal title to the share and deals with the share for the benefit of another person. In such a case the nominee shareholder is a bare trustee whose sole duty is to maintain the trust property and convey the legal estate (ie, the share) to the beneficiary, if so requested.[38] A leading Australian textbook on trusts states:

> A more precise use of the term 'bare trustee' is to identify a trustee who has no legal interest in the trust asset, other than that existing by reason of the office of the trustee and the holding of the legal title, and who never had any active duties to perform or who has ceased to have those duties with the result in either case the property awaits transfer to the beneficiaries or at their direction.[39]

A bare trustee has no interest in the shares of a registered company apart from holding those shares on behalf of the beneficiary. This is recognised by companies legislation in most countries, where a bare trustee is exempted from the obligation to disclose a substantial interest in the shares of a listed company. For example, s 609(2) of the Corporations Act in Australia provides that:

> A person who would otherwise have a relevant interest in securities as a bare trustee does not have a relevant interest in the securities if a beneficiary under the trust has a relevant interest in the securities because of a presently enforceable and unconditional right of the kind referred to in sub-section 608(8).

In *Corumo Holdings Pty Ltd v C Itoh Ltd*,[40] the NSW Court of Appeal considered the meaning of the 'bare trustee exception' under s 8(8)(a)(iii)(B) of the Companies (New South Wales) Code 1981. The question in this case was whether Mr Stapleton who held a share in a listed company as trustee was a bare trustee and thereby exempt from substantial holder disclosure. Under the trust deed, Mr Stapleton was required to vote in respect of the share and execute notices, transfers and other instruments as directed by Ito Ltd (the beneficial owner), and to pay all dividends and other benefits to Ito Ltd, or as directed by it. In finding that Stapleton was a bare trustee, Meagher JA, with whom Samuels JA agreed, stated:

> A 'bare trust' is one in which the trustee has no active duties to perform and is usually contrasted with a trust where there are such active duties. . . . As a matter of strict logic a person in [the trustee's] position would theoretically have been in a position where he had an active independent duty to perform in some circumstances,

38 *Herdegen v Federal Commissioner of Taxation* (1988) 84 ALR 271 at 281 per Gummow J; *Christie v Ovington* (1875) 1 Ch D 279 at 281 (V-C Hall).

39 R P Meagher and W M Gummow, *Law of Trusts in Australia*, Butterworths, Sydney, 1997, para 319.

40 (1991) 24 NSWLR 370; 5 ACSR 720.

> for example if he found himself so situated that he had to vote at a formal meeting and [the beneficiary] had declined to instruct him how to exercise his vote. But, as a matter of strict logic, almost no situation can be postulated where a trustee cannot in some circumstances have active duties to perform. The applicants would have the phrase confined to situations where the trustee was immediately bound to transfer the share to his beneficiary. But this, in my view, is too narrow a construction, and would result in reading down the phrase so that it applied only to situations which almost never occur.[41]

The court in *Corumo*'s case considered that the purpose of the 'bare trustee exception' was to disregard persons who 'in a practical sense, have no say in the utilisation of the powers attached to those shares'. Where a trustee is a 'nominee or cypher in a common sense commercial view' then it is a bare trustee. Other courts have also described a bare trustee as a 'naked trustee',[42] or a 'dummy' for the true owner.[43] The critical question is whether a trustee has authority to exercise independent discretion in dealing in the interests in shares or in exercising rights attached to those interests. The rule is that a trustee of a bare trust must be obliged to and act strictly on the instructions of the beneficiary. However, where the beneficial owner has declined or failed to give instructions on a matter, a trustee may still be considered a bare trustee even though it is empowered to and does vote on an issue affecting the trust property.[44]

Although a bare trustee which holds shares in its name is sometimes called a nominee, it is not the case that all nominee shareholders are bare trustees. A nominee that is a bare trustee must be distinguished from an active trustee, which has significant powers and responsibilities in relation to the trust property. Equity has regard to substance over form. This means that where the registered shareholder holds the share as bare trustee for another person, who in turn holds the share as bare trustee for a third person, equity would 'disregard the interposed beneficiary whom it would see as having no interest in the property (ie the share) at all'.[45] A trust to be valid must be certain. This means that under trust law a bare trustee is required to know who the beneficiaries are, or at least must know whether a person is a beneficiary or not. A nominee shareholder that is a bare trustee is not required to know whether its client beneficiary is holding the share under a sub-trust for others. A nominee may thus be unaware that the share is held under a series of sub-trusts which conceal the 'real owner', sometimes called the ultimate beneficial owner (UBO).[46]

There is no common law principle or doctrine of equity requiring the

41 Ibid, at NSWLR 398–9.
42 *Morgan v Swansea Urban Sanitary Authority* (1878) 9 Ch D 582 at 585.
43 *Tomlinson v Glyns Executor and Trustee Co* [1970] Ch 112 at 126.
44 *In the Matter of Aulron Energy Ltd* [2003] ATP 31 (unreported, 22 September 2003, BC200307607) at [96] citing *Australian Securities Commission v Bank Leumi Le-Israel* (1995) 18 ACSR 639 at 684; 134 ALR 101.
45 *Corin v Patton* (1990) 169 CLR 540 at 579 per Deane J; 92 ALR 1.
46 For an example of the use of a chain of nominees to circumvent the Australian substantial shareholder disclosure requirement, see *Re North Broken Hill Holdings Ltd* (1986) 4 ACLC 131; 10 ACLR 270, and on appeal, see *Crosley Ltd v North Broken Hill Holdings Ltd* [1987] VR 119; (1986) 4 ACLC 432.

identification of the 'ultimate beneficial owner.' Michael Ashe QC makes the astute observation:

> In law, if there is no requirement that true ownership is disclosed there is nothing legally wrong in its concealment and although it is not wholly clear this will often be implicit in the relationship between a nominee and his beneficiary that the latter's identity will not be disclosed.[47]

6 Rationale of nominee shareholders

The practice of using nominees developed largely as an administrative convenience so as to separate the shareholdings of an individual from other activities. Nominee arrangements facilitated the administration of property such as shares, as well as dividends or distributions associated with those shares. Administration of a deceased estate or an inheritance, or property held on behalf of a child or a person with a mental disability will usually require the use of a nominee arrangement or trust. The Corporations Act recognises the important role of nominees in administering shares. For example, under s 1072E of the Act a trustee, executor or administrator of the estate of a dead person, who is the registered holder of shares, may apply to be placed on the share register. A similar situation applies to an administrator who is appointed to administer the estate of a person who is incapable of managing his or her affairs. The Official Trustee in Bankruptcy may also apply under s 1072E (6) and (7) of the Act to be registered as the holder of shares which have been vested in it as part of the estate of the bankrupt. In a wide range of circumstances, nominees provide a valuable legal tool for executing important and legitimate business services. Solicitors and accountants use nominee companies for carrying out important functions of their businesses.

Another key motivation for the use of nominee shareholdings is financial privacy. Businesses seek financial privacy because it may be fundamental to the carrying out of a business plan. For example, beneficial owners of a company may not wish to have their name on the public record where that company is purchasing real estate for the purpose of conducting a land assembly. Premature disclosure of the underlying beneficial owners of the company may result in an increased market price for the properties which are being acquired and undermine the viability of the proposed real estate investment project. Privacy in securities transactions is highly valued by investors who wish to conceal their identity for reasons of business efficacy. For example, where an institutional investor wishes to dispose of or purchase a large block of securities, it may use a number of nominee companies to sell or buy the shares at the best possible price. Corporate deal makers and corporate raiders rely on the privacy advantages of nominee companies to execute investment deals and takeovers. Investment plans would be frustrated and profits from arbitrage lost if third parties could prematurely discover the identity of underlying interests and then 'piggy back' on those plans.

Nominees are also used for the purposes of disassociating public officials from the temptation to take advantage of their position and/or to avoid

47 M Ashe, *Nominee Shareholding*, Report submitted to the Commonwealth Law Ministers Meeting Barbados, Commonwealth Secretariat, London, 1980, para 26.

imputations of tainted conduct. In a number of countries where business persons take up public office, they will either dispose of their investments or place their securities in the hands of a nominee with full discretionary management. Blind trusts are viewed as an effective way to manage potential conflicts of interest. Ministers of Government who put their investments in blind trusts when assuming public office will be protected from accusations of impropriety and will enjoy a measure of financial privacy.[48] It is not necessarily in a State's interest to require the disclosure of beneficial ownership. The exploitation of nominees by governments may be an important mechanism for pursuing national policy. For example, the People's Republic of China owns and directly controls a vast amount of property and interests in securities in nominee form in Hong Kong. It was because of the political sensitivity of the Chinese Government's shareholdings interests that prior to 1997 the Hong Kong Government did not enact adequate shareholder disclosure laws.[49]

7 Nominee shareholders and the capital markets

The utility of nominee shareholdings has expanded beyond considerations of administrative convenience and financial privacy. Nominee arrangements have been critical to the development of securities and capital markets. It is not just a coincidence that countries in the civil law tradition, which historically have not recognised the concept of nominees, have experienced problems in developing efficient clearing and settlement systems.[50] Given that settlement of securities transactions will usually involve several layers of intermediaries, it is more efficient and less costly to process securities transactions by using nominee arrangements. The absence of nominee holdings will inevitably result in increased settlement risks.[51] The demand for efficient systems for registering, holding, transferring and clearing securities transactions has resulted in securities not only being used in a nominee form but in securities becoming a species of international currency. Indeed, securities are referred to as such in the documentation governing the integration of the European capital markets. The need for a common form which nominee registration facilitates is illustrated by the documentation of the Eurobond market.[52] All these factors have contributed to nominee arrangements becoming an essential part of the infrastructure of the world's capital and financial markets.

There is a trend towards increased nominee registration in the complex and

48 B Pullen, 'Conflicts of Interest Avoidance: Is there a Role for Blind Trusts?', Economics, Commerce and Industrial Relations Group, *Current Issues Brief*, No 14, 1996–1997, available at <www.aph.gov.au> (accessed 8 February 2005).

49 B Rider, *Commercial and Organised Crime in Hong Kong — Proposals for combating the problem*, report prepared for HM Government, transmitted through the Attorney-General of Hong Kong, 1984.

50 See Euroclear, *Harmonisation Fundamentals: Euroclear Business Model Implementation*, 30 June 2004, para 8.3, available at <www.euroclear.com> (accessed 20 January 2005).

51 M Guadamillas and R Keppler, *Securities Clearance and Settlement Systems: A Guide to Best Practices*, April 2001, World Bank Policy Research Working Paper No 2581, p 9.

52 See R S Rendell (Ed), *International Financial Law: Lending, capital transfers and institutions*, Euromoney Publications, 1990, Ch 4.

sophisticated securities and capital markets. All professional intermediaries in the securities industry use nominees. Increased nominee participation in the securities industry is most evident where banks act as depositaries and agents for overseas principals. The commercial reasons for nominees are not usually concerned with matters of financial privacy or concealment, as is shown by the following examples.

(i) Private client investors

A private client investor who retains a traditional portfolio of investments may place shares in the name of a nominee company which provides administrative services, such as collecting dividends and preparing paperwork for tax purposes. Where a private client investor places a portfolio of shares under the control of a discretionary fund manager, the shares will inevitably be placed in the name of a nominee so as to facilitate the rapid transfer of shares.

(ii) Stockbrokers

Stockbrokers will typically have nominee companies for at least two purposes, for example, to hold shares purchased by brokers on their own account, and to hold shares as agents or custodians for others. Australian stockbrokers establish distinct nominee companies for each of these purposes. Regulatory requirements will often require the use of nominee companies to facilitate the segregation of clients' monies from monies of the stockbroker. The development of execution-only brokers and dealing of shares through internet share brokers has also encouraged the increased use of nominees.

(iii) Institutional investors

Institutional investors, such as mutual funds, pension funds and their managers, control a large volume of the world's investments. Institutional investors will usually employ professional managers of their own principal investment and those of their clients. Professional investment managers invariably use nominee companies to hold the shareholding interests. The advantage of nominee companies is that they reduce the administrative burden of handling company documentation, such as annual reports, and the distribution of entitlements connected to shareholdings, such as dividend issues and rights issues.

(iv) Custodians

Custodians play a significant role in the efficient management of the financial services industry. Many investment management firms will outsource some of their investment management administration to companies which provide specialist custodian functions. The Australian Custodial Services Association describes the practices of the industry as follows:

> Typically a custodian trustee is a nominee company which acts as the bare trustee holding an investment on behalf of the beneficial or equitable owner of the particular investment. These nominee companies are often special purpose subsidiaries of financial institutions. Investors that use the services of nominee companies are usually institutional investors such as investment trusts and superannuation and pension funds or fund managers acting on behalf of these types of institutions. The

institutions will often be non-residents. Also many foreign central banks employ the services of locally based nominee companies in Australia to facilitate investment in Australia.[53]

Under the custodial arrangements the custodian becomes the shareholder of record, while the investor's rights will be solely against the custodian and not against the issuer of the shares. The depositing of securities with a custodian is sometimes described as the immobilisation of securities in that it involves the breaking of a direct link between the investor and the issuer.[54] The holding of securities by a custodian in its own name for the benefit of its customers involves a fiduciary relationship. This should be distinguished from custodians who merely act as bailees, holding the securities for physical safekeeping for their customers, but without becoming the shareholder of record. The practice of using custodians to safeguard and administer assets, especially investments, is so widely accepted that the United Kingdom Treasury[55] has described the use of custodians as 'best practice' in the investment industry. In the United States, the Securities and Exchange Commission rules[56] require US mutual fund managers, whenever they make an investment decision, to take into consideration the local market depositories and the safety of underlying assets during the settlement process and in on-going safe custody.

(v) Cross border portfolio investment

The internationalisation of capital markets, as evidenced in the increase in ownership of shares by foreign non-residents, has also resulted in an increased demand for nominees. Investors holding overseas investments will use nominees, such as banks, broker-dealers and other financial intermediaries, to trade in shares and other securities. Administrative convenience and lower transaction costs ensure that nominees will continue to be popular among foreign investors.

(vi) American depository arrangements

The most widely used form through which non-US companies offer and trade their shares in the US equity markets are American Depository Receipts (ADRs).[57] First created by the investment bank J P Morgan in 1927 for the British retailer, Selfridges, ADRs are used by European, Asian and Australian companies. Over 74 major Australian companies, including NAB, Westpac,

53 Australian Custodial Services Association, *Securities Custody and Financial Institutions Duty*, September 1996, pp 1–2, available at <http://fsi.treasury.gov.au/content/downloads/PubSubs/000051.doc> (accessed 10 January 2005).

54 See R Goode, 'The Nature and Transfer of Rights in Dematerialised and Immobilised Securities' in F Oditah (Ed), *The Future for the Global Securities Market*, Clarendon Press, Oxford, 1996, pp 110–12.

55 Treasury, *Custody: A Consultation Document*, HMSO, June 1996. See also Law Commission, *The Employment of nominees and custodians — the practice and its advantages*, HMSO, London, 1997.

56 Securities and Exchange Commission Rule 17f-7, which came in effect on 12 June 2000.

57 The volume of trading in ADRs in 2003 amounted to $US660 billion with 22 billion shares traded. In 2000 volume was $US1100 billion with 35 billion shares traded. See <www.adr.com> (accessed 10 December 2004).

ANZ, Coles Myer, BHP-Billiton, CSR, Fosters, Lend Lease and Southcorp have shares that are issued and traded under an ADR arrangement. Two concepts, American Depository Shares (ADS) and American Depository Receipt (ADR) require explanation. An ADS has been described as:

> a US dollar denominated form of equity ownership in a non-US company. It represents the foreign shares of the company held on deposit by a custodian bank in the company's home country and carries the corporate and economic rights of the foreign shares, subject to the terms specified on the ADR certificate.[58]

The American Depository Receipt (ADR) is defined as:

> the physical certificate issued by the custodian bank as evidence of ownership in one or more ASRs. The ADR holder is either a directly registered holder of the certificate or the beneficial owner of the certificate where it is held through a nominee, such as a bank, custodian or broker. In either case the actual underlying shares of the issuer are registered in the name of the custodian bank.[59]

Under ADR arrangements, the actual underlying shares of the issuing company are registered in the name of a custodian, usually a bank, which issues a physical certificate to the shareholder as evidence of ownership.

(vii) Dematerialisation

Historically all securities were issued in a materialised form, that is, with a certificate or physical instrument evidencing ownership. In contrast, dematerialised securities have no physical document of title, for example, no share certificate in the case of shares issued by a corporation. Initially dematerialised securities were used only in cases of investment in securities issued by governments and other public institutions. They are now available for securities issued by corporations. The desire to eliminate the paper mountain associated with materialised securities and the demand to trade securities electronically has resulted in dematerialised securities becoming the norm in many countries. The process of dematerialisation of shares involves the confirmation to the investor that its shareholding has been registered as an electronic holding. Although it is not a requirement, in practice dematerialisation and other market influences drive active shareholders into nominee holdings because of cost and convenience.[60]

(viii) Financial products

Innovation in financial products is a major source of competitive advantage for financial institutions, especially investment banks. The supply of new financial products and financial instruments has spawned an increased use of nominee arrangements. Many financial products which are offered to the retail market can only be held under a nominee arrangement.[61] The feasibility and

58 J P Morgan Group, *ADR Reference Guide*, September 2004, p 45, available at <http://www.adr.com/pdf/ADR_Reference_Guide.pdf> (accessed 10 December 2005).

59 Ibid, p 46.

60 See G Oldham, *Nominee Service versus Certificate*, March 2003, available at <www.uksa.org.uk/Nominees_v_Certificates_2002.pdf> (accessed 15 December 2004).

61 An Australian example is the Commonwealth Bank long dated instalment warrant. English examples are PEPs and ISAs.

success of these financial products will depend on low administrative costs which are achieved through the use of nominee administration. It is expected that there will be an increase in financial products which are retailed in a nominee form.

7 Risks of nominee shareholders

The OECD claims in a report published in 2001[62] that nominee shareholders are one of the primary mechanisms to obscure beneficial ownership and control. There is no doubt that the use of nominees reduces the usefulness of shareholder registers in that the registered shareholder may not be the ultimate beneficial owner of the shares. Although acknowledging that nominees serve legitimate purposes, the OECD report argues that nominees are used to conceal illegal transactions. The accommodation of secrecy that nominee shareholding allows has being criticised mainly from the viewpoint of changes in corporate control, especially through takeover activity,[63] rather than in the context of criminal or seriously abusive conduct. Shareholders are concerned that nominees may facilitate secret changes in the control of their companies which can profoundly affect the value of their shares. There is also the likelihood that nominees may conceal securities-related offences, such as insider trading and market manipulation. These problems relate to the public securities markets and are largely addressed by laws requiring substantial shareholder disclosure in the case of listed securities.

The main concern of the OECD report is the potential use of nominees for criminal purposes, especially money laundering. It is not surprising that financial criminals will use various corporate devices, including nominees, to obscure, if not completely hide, criminal activity and the proceeds of crime. The risk of using nominees includes the penetration of companies by organised crime and the execution of a variety of financial crimes. The OECD report questions the financial privacy rationale of nominee shareholdings, arguing that since the anonymity aspect of nominees may be misused, the remedy is for increased disclosure, especially in the case of offshore jurisdictions. The OECD critique of nominees is made without giving any weight to the legitimate demands for financial privacy. The OECD report presumes that the mere fact that a corporate instrument may be misused provides sufficient ground for imposing a new regulatory regime. The report provides little empirical evidence to support its underlying assertion that nominee shareholders are a significant problem in cases of money laundering.

Nominee shareholdings are only one of many devices that are open to those who wish to conceal their interests in shares for illicit reasons. In 1981 the Securities Commission of New Zealand[64] identified the following methods of concealing ownership and/or control:

(a) registered holder by express agreement confers rights in relation to shares;
(b) registered holder is bare trustee;
(c) registered holder is active trustee for beneficiaries;

62 OECD, above n 2, p 31.
63 See *Report of the Company Law Committee*, above n 13, para 142.
64 Securities Commission of New Zealand, above n 12, pp 125–8.

(d) use of agency procedures, such as powers of attorney;
(e) vendor pending completion of contract for sale of shares;
(f) option in respect of shares;
(g) financier who has lent money against security of shares;
(h) registered holder is a party to a voting agreement or voting trust;
(i) warehousing of shares; and
(j) control through a string of companies.

It is apparent from the above list, that a nominee shareholding arrangement is only one of many devices that are open to those who seek to conceal their interests. There is the classic nominee situation, sometimes described as a 'bare trust' (see (b) above) and a chain of nominees (see (j) above). Furthermore, the above list is not exhaustive. Developments in structured finance and financial engineering have resulted in a range of instruments, structures or arrangements which may circumvent the very best corporate laws mandating disclosure of interests in shares. Whether nominee shareholdings impose a greater risk of misuse than other corporate devices or financial instruments is an unanswered question. Corporate directors, nominee directors, bearer shares, foundations, derivative instruments and swaps may be used singularly, or in a combination, to conceal ownership and control. Nominee shareholdings do not present the same degree of anonymity as bearer shares, which are prohibited in Australia.[65]

8 Conclusions

When the registered company was first developed in the nineteenth century there was no legislative requirement for the disclosure of beneficial shareholdings. In the latter part of the twentieth century many developed countries passed laws requiring the disclosure of substantial holdings in shares of companies trading in public securities markets. These laws apply to a small number of companies, usually listed on an exchange. There is nothing illegal or unethical in using nominees as part of a private or commercial arrangement. In the case of a nominee, there is no common law principle or doctrine of equity requiring the identification of the ultimate beneficial owner of securities. The traditional justification for laws requiring the disclosure of substantial holdings of listed companies has no application in the case of proprietary or private companies. Any proposal to extend the substantial shareholder disclosure regime to proprietary companies requires separate justification, which has not yet been forthcoming.

Nominee arrangements are now an essential part of the infrastructure of the world's financial markets. The wide varieties of commercial uses of nominees impose practical limits on any increased regulation on nominees. It is too late to suggest that nominee shareholdings be prohibited, since this would undermine an essential component of the markets. Financial privacy provides a motivation for using nominees in shareholder arrangements. Financial privacy is important to individuals who do not wish the world to know of their investments. Financial privacy may also fuel investment by entrepreneurs,

65 See s 254F of the Corporations Act which provides that a company does not have the power to issue bearer shares.

business operators, corporate deal makers and governments. There is an argument that the financial privacy justification for nominee shareholdings should be discarded because nominee shareholdings may be used for illicit purposes. This argument ignores the legitimate demands for financial privacy. Nominee shareholding arrangements have existed for over 160 years and are only one of many devices that are open to those who wish to conceal their interests in shares for illicit reasons.

Articles

Penetrating foreign nominees: A failure of strategic regulation?

*Dr David A Chaikin**

The widespread use of nominees[1] in the financial services markets raises important questions as to the effectiveness of the tracing or disclosure notice provisions in the Corporations Act 2001. In this article I examine how the Australian courts have dealt with contraventions of the tracing notice requirements by foreign nominees. The failure of the Australian corporate regulator's tracing powers to penetrate the Swiss nominees in ***ASC v Bank Leumi*** *has created a precedent which has undermined the strategic enforcement objective of detecting insider trading and other abusive market conduct. The tracing notice powers are unlikely to be effective in unraveling corporate criminal misuse of foreign nominees. The judicial system for imposing remedial orders for violations of corporate law has no deterrent effect in cases where the beneficial shareholders' desire for secrecy is the highest priority. On the other hand, recalcitrant foreign nominees face the risk that their clients may lose entitlement to maintain their shareholding if they do not comply with a tracing notice. The judicial remedies for tracing notice violations are most effective in removing a secret shareholding from the market. This assists the strategic policy goal of maintaining a fully informed market.*

1 The policy of substantial shareholder disclosure and enforcement

In nearly all advanced economies which have sophisticated, liquid and efficient share markets, there are laws requiring the disclosure of substantial interests in shares of public or listed, companies.[2] For example, in 1972 Australia introduced a statutory regime for the disclosure by persons of 'substantial holdings' in the securities of listed companies. Under the

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1 There is no definition of a nominee in the Australian Corporations Act. The classic nominee is a shareholder who is registered with a company, and who holds the bare legal title to the share, and is under a legal obligation to deal with the shares for the exclusive benefit of another person. See D Chaikin, 'Nominee shareholders: Legal, commercial and risk aspects' (2005) 18(3) *Aust Jnl of Corp Law* 288.

2 See, eg, EU Large Holdings Directive which requires that the legislation in EU countries impose a minimum disclosure standard for listed companies of 10% in the case of substantial shareholdings. See also Securities Exchange Act 1934 Regulation 13d-1(b)(i) (USA).

Australian law a disclosure obligation arises when a person has a relevant interest in shares which carry 5% or more of votes. Disclosure is made to the company and the relevant exchange.[3]

The Eggleston Committee's justification for shareholder disclosure was as follows:

> shareholders are entitled to know whether there are in existence substantial holdings of shares which might enable a single individual or corporation, or a small group, to control the destinies of the company, and if such a situation does exist, to know who are the persons on whose exercise of voting power the future of the company may depend.[4]

It is not only existing shareholders that have a legitimate expectation of substantial shareholder disclosure. Investors who are contemplating the purchase of shares consider that the identity of the current or potential controllers of the business of the company is a very important piece of investment information.[5]

Policy discussions of a law requiring substantial shareholder notification have often occurred in the context of takeovers. A key justification for substantial shareholder disclosure is to ensure that changes in control of a listed company take place in a fully informed, efficient and competitive market.[6] This requires that bidders or potential bidders in a takeover of the company be identified.

Another justification for a law requiring the disclosure of substantial share holdings is that it may facilitate the identification of insider trading[7] or market manipulation of shares. The idea is that the disclosure of significant trading in shares may provide a trigger for an investigation into abusive share practices.

The need for an effective mechanism to police the substantial shareholder law has been recognised by the enactment of a special investigatory power. Since 1981 a listed company in Australia has been empowered to issue disclosure or tracing notices to its shareholders. The tracing power may also be used by the Australian Securities and Investment Commission (ASIC). It has been extended to facilitate the tracing of the beneficial ownership of shares[8] that are held under a nominee arrangement.[9]

The internationalisation of the securities markets and the widespread use of

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3 For example, the Australian Stock Exchange which has 1774 companies with a domestic market capitalisation of $975 billion as at 30 June 2005. See <www.asx.com.au> (accessed 31 March 2006).

4 Company Law Advisory Committee to the Standing Committee of Attorneys-General, *Second Interim Report*, Chairman R M Eggleston, Commonwealth Government Printing Office, Canberra, February 1969, para 4.

5 S R Bishop, 'Pre Bid Acquisitions and Substantial Shareholder Notices' (1991) 16 *Australian Jnl of Management* 1 at 2.

6 See ASIC Policy Statement 159, *Takeovers, compulsory acquisitions and substantial holding notices*, November 2004, at 159.270–271.

7 See Explanatory Memorandum for the Companies and Securities Legislation (Miscellaneous Amendments) Bill 1983, para 371.

8 The tracing of beneficial ownership of shares refers to the investigatory process of ascertaining the identity of the real owners of the company. See D Chaikin, 'Asset Tracking in Australia' in B A K Rider and A Ashe (Eds), *International Tracing of Assets*, looseleaf service, FT Law & Tax, 2002.

9 A nominee arrangement is one where the registered shareholder is not the beneficial owner

nominees in the financial services markets raise important questions as to the effectiveness of the tracing or disclosure notice provisions in the Corporations Act 2001 (Cth). The Australian tracing or disclosure power faces its major challenge where the shares are held by a foreign nominee who is protected by foreign secrecy laws.[10] There is the question of the applicability of the Australian law to persons who have no physical presence in Australia. There is also the potential conflict between an Australian law requiring a foreign nominee to disclose the identity of its client and a foreign secrecy law which forbids such disclosure.

In this article I examine how the Australian courts have dealt with contraventions of the tracing notice requirements by foreign nominees. The leading case is *ASC v Bank Leumi* (*OAP* case)[11] where the Federal Court comprehensively dealt with a range of extraterritoriality issues pertaining to Swiss nominees who had refused to disclose the identity of the owners of a 38% stake in Offset Alpine Printing Group Ltd (OAP). I will argue that the failure of the Australian Securities Commission (ASC), the predecessor to ASIC, to penetrate OAP in 1995 has created a precedent which has severely hampered the investigatory objects of the statutory regime.

2 Disclosure or tracing notice requirements

Section 672A(1) of the Corporations Act provides that ASIC and a listed company have the power to trace the beneficial ownership of the shares of a listed company by issuing tracing or disclosure notices. The tracing power is drawn in the widest possible terms. There is no significant precondition for exercising the power, for example, that there is a suspicion that a person has failed to make a substantial holding disclosure.

A disclosure or tracing notice in s 672A may be issued to a member of the company who may well be a nominee. Subsequently it may be issued to any person identified in a previous disclosure, as having a relevant interest in, or having given instructions about, voting shares in a company.

Where a person has been given a direction under s 672A, the following information must be disclosed:

(a) full details of that person's relevant interest in the shares, as well as the circumstances giving rise to that interest;
(b) the name and address of any other person who has a relevant interest, together with details of the nature of that person's interest and the circumstances that gave rise to that interest; and

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of the shares. For a discussion of the legal devices that conceal beneficial ownership, including nominee shareholdings, see Chaikin, above n 1, at 297–302.

10 Foreign secrecy laws are laws that impose a criminal penalty for violation of foreign banking or corporate confidentiality laws. See D Chaikin, 'Policy and Fiscal Effects of Swiss Bank Secrecy Laws' (2005) 15 *Jnl of Revenue Law* 55 available at <http://www.bond.edu.au/law/rlj/contents/Vol15.pdf>.

11 *Australian Securities Commission v Bank Leumi Le-Israel (Switzerland)* (1996) 69 FCR 531; 139 ALR 527 (Full Fed Ct); (1995) 18 ACSR 639; 134 ALR 101 (Sackville J).

(c) the name and address of any other person who has given the person instructions about (i) the acquisition or disposal of the share, (ii) the exercise of any voting or other rights attached to the shares, or (iii) any other matters relating to the shares.[12]

The tracing notice power is designed to obtain shareholder information in a speedy fashion. The person who replies to a direction under s 672A must provide the information within two business days after the person has been given the direction.[13] This time limit imposes major practical difficulties on foreign nominees who have no standing instructions from their clients as to how to respond to a tracing direction.

A failure to comply with a disclosure notice is a criminal offence, which is punishable by a fine and a maximum imprisonment of six months, or both. Contraventions of the disclosure notice requirement also give rise to potential civil penalties. A person who contravenes s 672A is also liable to compensate any person who suffers loss or damage as a result of the contravention. There are a large number of remedies that a court may apply in relation to a contravention.

3 Overview of the *OAP* case

In 1995 the Australian Stock Exchange (ASX) commenced an investigation into the shares of OAP, a listed company which specialised in printing. The ASX was concerned that substantial shareholding notices had not been filed in circumstances where OAP was conducting an on market buy-back scheme under which OAP could acquire up to 2,485,015 of its shares, representing approximately 10% of its capital.

The ASX made a complaint to the ASC which sought to identify the beneficial ownership of OAP, by issuing tracing notices[14] to five Australian nominee companies. Those companies identified Bank Leumi Le-Israel (Bank Leumi), a Swiss bank,[15] and EBC Zurich AG (EBC), a Swiss finance company, as the holders of 16.97% and 22.25% respectively of the issued capital of OAP. The ASC then issued secondary tracing notices[16] to the Swiss nominees which refused to supply any information on the ground that this would breach Swiss bank and commercial secrecy laws.

Subsequently, at the request of the ASC, the Federal Court issued interim freezing orders against the secret share block in OAP on the basis that the Swiss financial institutions had failed to comply with ASC's tracing notices and had failed to disclose that they were substantial shareholders in OAP.[17] The effect of the freeze orders was that the Australian nominee companies

12 Corporations Act s 672B(1).

13 Corporations Act 2001 s 672B(2). An application may be made to ASIC to modify the time limit under s 673, but ordinary confidentiality requirements of nominees do not provide a reason for delaying a response. See ASIC Policy Statement 86, *Beneficial Ownership Notices*, at PS86-33.

14 Under s 718 of the Corporations Law (now s 672A of the Corporations Act 2001).

15 Bank Leumi Le-Israel is the Swiss subsidiary of Bank Leumi, Israel's second largest commercial bank. EBC Zurich is a non-bank subsidiary of Bank August Roth AG, a Swiss bank. See G Woernle, *The Wernlin Director*, Wernlin, Geneva, 2000.

16 Under s 719 of the Corporations Law (now s 672A of the Corporations Act 2001).

17 ASIC Media Release 95-65, 'Offset Alpine Printing Group Ltd', 4 May 1995.

were prohibited from disposing of the shares or dealing with them without the permission of the court.

In the ensuing proceedings, Justice Sackville (the trial judge) held that Bank Leumi and EBC had breached the law by failing to comply with the tracing notice provisions even though compliance with the requirements would entail a risk of breach of Swiss secrecy laws.[18] His Honour ordered that the secret share parcels be sold but refused to vest the shares or the proceeds of the shares in the ASC as a mechanism for 'flushing out' the beneficial shareholders. Sackville J's judgment was upheld on appeal to the Full Federal Court (Lockhart, Foster and Lehane JJ).

4 Extraterritorial application and enforcement of corporate securities laws

An enforcement model in relation to foreign nominees must first deal with the issue whether and the extent to which the Corporations Act applies to conduct outside Australia. There is a common law presumption that legislation does not operate extraterritorially.[19] This may be rebutted. For example, s 5(4) of the Corporations Act extends the Act to 'natural persons, whether resident in Australia or not and whether Australian citizens or not, all bodies corporate, whether formed or carrying on business in Australia or not, and acts and omissions outside Australia'.

Judges in Australia have applied the corporations legislation extraterritorially to foreign entities, including Swiss banks. For example, in 1983 the Supreme Court of South Australia[20] held that the failure of Bank Cantrade AG Zurich, a Swiss bank, to lodge a substantial shareholder notice amounted to a contravention of s 137 of the Companies (South Australia) Code even though disclosure of the information would violate Swiss bank secrecy laws. In 1986 the Supreme Court of Victoria[21] held that the tracing

18 Sackville J also found that EBC contravened the substantial shareholder disclosure provisions of the Corporations Law, but that Bank Leumi did not breach these provisions because Bank Leumi held its shares as a bare trustee. Under s 609(2) of the Corporations Act a bare trustee is exempted from the obligation to disclose a substantial interest in the shares of a listed company. The reason for the exemption is that a bare trustee has no interest in the registered shares of a company apart from holding those shares on behalf of the beneficiary. See Chaikin, above n 1, at 294–5.

19 See *Jumbunna Coal Mine NL v Victorian Coal Miners Association* (1908) 6 CLR 309 at 363 per O'Connor J; 14 ALR 701. See also para 21(b) of the Acts Interpretation Act 1901 (Cth) which mirrors the common law presumption.

20 See *Corporate Affairs Commission (SA) v Orlit Holdings Ltd* (1983) 8 ACLR 164 per Milhouse J. The secret beneficial owners of the 15.58% share parcel in Orlit Holdings which were purchased on instructions of Bank Cantrade were never revealed. Although the court found that Bank Cantrade had violated Australian law, it refused to impose an order restraining the sale of the secret share parcel, because this would unfairly prejudice the new owners of the shares as well as the Australian nominee companies, which would suffer reputational damage if they failed to deliver the script pursuant to an agreement to sell the shares.

21 *Re North Broken Hill Holdings Pty Ltd* (1986) 10 ACLR 270. In this case R Brierley used 13 separate nominee companies in seven countries to prevent the directors of North Broken Hill Holdings Ltd (NBH) from discovering Industrial Equity Ltd's (IEL) strategic stake in the company. NBH then issued a series of successive tracing notices which led it on a tour of the world's tax havens. After three months in which NBH issued notices to nine nominee

notice legislative requirement[22] applied to Bank Julius Baer & Co AG, a Swiss bank, even though it was neither registered nor carrying on business in Australia.

In the *OAP* case, Justice Sackville observed that 'considerable caution must be exercised before construing legislation so as to impose duties on foreigners which create a risk that they may be required to contravene a foreign law'.[23] The foreigners in the *OAP* case were Swiss financial institutions which had no physical presence in Australia and whose only known connection with Australia was that they had instructed Australian nominees to purchase shares on their behalf.

Justice Sackville examined expert evidence on Swiss secrecy laws before deciding whether there was any legislative limit to the compliance obligation.[24] There was no doubt that Bank Leumi, as a Swiss bank, was subject to Art 47 of the Swiss Federal Banking Law 1934. This provision imposes a criminal liability on a bank which discloses confidential information concerning its clients. There are exceptions[25] to Swiss bank secrecy, but none of these applied in the instant case. Bank Leumi's assertion that its client had refused to consent to the release of the information was accepted at face value by the Federal Court.

Since EBC was a finance company and not a bank, it could not rely on Art 47 of the Swiss Banking Law. EBC relied instead on Art 273 of the Swiss Penal Code[26] which imposes a criminal offence on persons who obtain a business secret in Switzerland in order to give it to a foreign government. Justice Sackville ruled that if EBC supplied the ASC with the requisite information there was a risk that it would violate Art 273 at least where EBC held the shares in OAP for a Swiss domiciliary.[27]

Justice Sackville did not have to decide whether there would be or should

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companies in the Cook Islands, Netherlands, Guernsey and Liberia, NBH still had not discovered the identity of the ultimate beneficial owner. Fullagar J's interlocutory order vesting the share parcel in the National Companies and Securities Commission flushed out IEL as the secret beneficial owner.

22 Under s 261 of the Companies (Vic) Code.

23 (1995) 18 ACSR 639 at 663; 134 ALR 101. At the time of the *OAP* case the court had to consider the effect of s 110 of the Corporations Law which was the predecessor to s 5(4) of the Corporations Act 2001.

24 In the *OAP* case there was a conflict of expert evidence as to whether there was a general practice among Swiss banks to seek their client's consent to the disclosure of information prior to agreeing to act on their behalf in securities trading. Justice Sackville found that there was no such general practice. His Honour was persuaded by the fact that the experts for Bank Leumi (Dr Schurman) and EBC (Dr Nobel) had 'rather more impressive qualifications and greater experience in (Swiss) banking law' than the ASC expert (Mr Weherli). None of the experts were subject to cross-examination.

25 There are three exceptions to Swiss bank secrecy: (a) if the customer consents to disclosure; (b) where Swiss law provides, for example under Swiss anti-money laundering legislation; and (c) where the bank is ordered by a competent Swiss court to provide disclosure. See Chaikin, above n 10, at 55–78. See, generally, M Aubert, *Swiss Bank Secrecy*, Stampfli & Cie, Berne, 1995.

26 For a detailed discussion of Art 273 of the Swiss Penal Code and other Swiss 'economic espionage penal laws', see D Chaikin, 'The Impact of Swiss Mutual Assistance on Financial and Fiscal Crimes' (2006) 16 *Jnl of Revenue Law* (forthcoming).

27 Sackville J also held that the service by the ASC of the tracing notices on the Swiss financial institutions by fax was authorised by the Corporations Law, even though the service of the

be a different result, if the client of the Swiss financial institution was a domiciliary, citizen or resident of Switzerland, Australia or a third country. His Honour held that foreign corporations, irrespective of the characteristics of their clients, were required to comply with tracing notices, even though this would create a 'real and appreciable risk' of the corporations contravening foreign law. He considered that any other conclusion would render the scheme of compulsory disclosure unworkable.[28]

5 Whether Swiss financial institutions should be excused?

Under the corporations law[29] the court may excuse a contravention of the substantial holder or tracing notice requirements. In determining whether to excuse a contravention, the court may take into account whether the contravention is due to a person's 'inadvertence or mistake', or that the person is not 'aware of a relevant fact or occurrence or to circumstances beyond the person's control'.[30]

In the *OAP* case Bank Leumi and EBC argued that they had taken all steps available to them under Swiss law to comply with the tracing notices in that they had sought unsuccessfully to obtain permission from their clients to provide the required information. They contended that if they had breached the Australian law, this was by reason of circumstances beyond their control.

Justice Sackville undertook a balancing exercise in deciding whether to excuse the Swiss nominees.[31] His Honour took into account the following circumstances favourable to the Swiss financial institutions:

- 'if a foreign corporation finds itself unable to comply with the requirements of Australian law, because it has been unavoidably placed in a position where to do so would conflict with the law of the

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notices violated Art 271 of the Swiss Penal Code. Article 271 prohibits the exercise of powers reserved for the public authorities in Switzerland. For an analysis of Art 271, see Chaikin, ibid.

28 (1995) 18 ACSR 639 at 665; 134 ALR 101.

29 Under s 743 (1) of the Corporations Law in the *OAP* case (now s 1325D of the Corporations Act 2001).

30 Under s 743 (3) of the Corporations Law in the *OAP* case (now s 1325D(4) of the Corporations Act 2001).

31 The case by case balancing exercise approach is one that has been used by courts in the United States when considering whether to excuse a foreign party who is resisting a US investigatory agency's subpoena on the ground that a foreign law forbids production of the documents in issue. See, eg, *Garpeg Ltd v United States* 583 F Supp 789 (SDNY 1984). See also American Law Institute, *Restatement (Third) of the Foreign Relations Law of the United States*, 1987, para 442(1)(c), which provides that in determining whether to issue an order requiring the production of information abroad, a US court should take into consideration the following matters: the importance to the investigation or litigation of the documents requested; the degree of specificity of the request; whether the information originated in the United States; the availability of alternative means of securing the information; the extent to which non-compliance with the request would undermine important interests of the United States; and the extent to which compliance with the request would undermine important interests of the state where the information is located.

country in which it does business, an Australian court would regard this as a very powerful reason to excuse a contravention of Australian law'.[32]

- the risk that the enforcement of Australian law might 'violate principles of international law'; and
- that the Swiss financial institutions had acted in good faith and were not a 'party to a deliberate attempt to circumvent Australian laws'.

Justice Sackville stated that these favourable matters were outweighed by the following factors:

- that contraventions related to a significant shareholding of 38% of the shares of an Australian listed company which should not be 'lightly excused';
- the predicament of the Swiss financial institutions was not 'wholly beyond their control' — they could have chosen to acquire Australian shares only on behalf of clients who were prepared to waive Swiss secrecy laws;[33] and
- there was an additional discretion in the court 'to limit the relief available to the ASC, so that neither Leumi nor EBC is compelled by the court order to provide the information sought in their secondary notices'.

In the particular circumstances of the case, Sackville J declined to exercise the statutory power to excuse the contraventions of Australian law. In the enforcement outcome of this case, the refusal of the court to exculpate the Swiss nominees did not have any deleterious consequences on the Swiss nominees. This was because ultimately the contest in the *OAP* case concerned the appropriate judicial remedy for contravening the tracing notice requirement.

6 Remedies for breach of corporate securities laws

Under s 1325(A) of the Corporations Act the court may make any order (including a remedial order) it considers appropriate if a person has contravened the substantial shareholding disclosure provisions or the tracing of beneficial ownership provisions. A remedial order is defined in s 9 of the Act and includes 16 different types of orders. It may be used to achieve various regulatory outcomes. The most powerful remedies, which may also be viewed as sanctions, are those that are directed against the shares themselves. For example, where there has been a breach of the law, a shareholder may be deprived of its shareholding and key shareholder benefits, such as the exercise of voting rights, the right to receive dividends, and/or control over the sale of the shares.

Remedial orders may be imposed once a breach of the law has occurred,

32 (1995) 18 ACSR 639 at 687; 134 ALR 101.

33 Under Swiss law a client of a Swiss bank may waive bank secrecy. The waiver is only valid if it is voluntary and not compelled by a foreign law enforcement agency or foreign court. See *Minpeco SA v Conticommodity Services Inc* 116 FRD 517 (SDNY 1987). See also Chaikin, above n 10, at 63.

however technical the breach.[34] The remedial orders have the potential to secure compliance by foreign nominees with corporate regulatory requirements. The reason is that for the purposes of private international law, the shares of a listed Australian company are property located within the Australian jurisdiction.[35] Shares of a corporation are susceptible to legal control by the judicial authorities in Australia, even though the person interested in the shares is overseas or unidentifiable.

The effectiveness of judicial remedies in the case of foreign nominees was raised in the *OAP* case where the ASC sought orders[36] which were designed to unmask the 'real owners' of the secret share parcel in OAP. The ASC applied for orders specifically enforcing compliance by Bank Leumi and EBC with their obligations under the tracing notice provisions. It also sought orders vesting the shares or their proceeds in the ASC, until the Swiss companies had made the requisite disclosure in relation to the tracing notices.

If the orders sought by the ASC had been granted by the court, the beneficial shareholders faced the risk that their share investment would be permanently frozen, in effect confiscated, if their Swiss nominees did not reveal their identity. The Federal Court refused to make the orders sought by the ASC.

Sackville J expressed the view that the relief granted must take into account the following matters:[37]

(a) an order cannot be made if it 'unfairly prejudices any person';
(b) the relief should advance the principal objective of the law, namely the creation and maintenance of an 'informed market for shares in listed Australian companies'; and
(c) an order should 'intrude to the least extent feasible upon principles of international comity, including the principle that a foreign corporation and its officers should not be required, by orders made by an Australian court, to perform acts that would or might infringe foreign law'.

His Honour considered that although a foreign corporation may breach Australian law, it is an appropriate exercise of discretion to take into account that the specific relief that is sought, for example, ordering disclosure of beneficial ownership in response to a tracing notice, may breach a foreign law. As the Full Federal Court stated in upholding Sackville J's judgment: 'it is, in general terms, unexceptionable, as an exercise in discretion to refuse specific relief if that relief would compel a breach of the law'.[38] This may be correct as a matter of judicial discretion, however, the policy question is whether an

34 It does not matter how technical the breach is. See *North Broken Hill Holdings Pty Ltd* (1986) 10 ACLR 270 at 286 where Fullagar J, referring to the powers of the court, stated: 'the legislature deliberately chose a small and high-pressure trigger for what is a very powerful and potentially destructive gun.'

35 See, generally, M Ooi, *Shares and Other Securities in the Conflict of Laws*, Oxford University Press, 2003.

36 Under s 742 of the Corporations Law. Note that the remedial orders that were available in 1995 were not as numerous as those that are available under the current law, but this does not affect the analysis or the utility of the *OAP* case.

37 (1995) 18 ACSR 639 at 690; 134 ALR 101.

38 (1996) 69 FCR 531 at 545; 139 ALR 527.

Australian court should give judicial recognition to foreign bank secrecy laws which may be inimical to Australia's national interest.

The Federal Court's decision in the *OAP* matter was complicated by the fact that a series of unconditional offers had been made for the shares in OAP after the ASC had commenced legal proceedings against the Swiss nominees. Justice Sackville held that each of the competing bidders for shares in OAP would suffer unfair prejudice if orders were made preventing the shares presently held by Bank Leumi and EBC from being made available for sale. This would occur if, for example, the court ordered the shares to be vested in the ASC, to be held by it until disclosure was made by Bank Leumi and EBC of the information sought in the tracing notices.

Sackville J considered but rejected an alternative course advocated by the ASC, to allow the shares to be sold to the highest bidder (thereby causing no prejudice to the offerors) and to freeze the proceeds of the sale until the identity of the beneficial shareholders was made known. His Honour found that the ASC proposal was punitive in that it would punish the beneficial shareholder rather than affecting the principal objectives of the legislation.[39]

Justice Sackville was of the opinion that the remedial powers did not include the power to make an order designed to 'punish those who, rightly or wrongly, might be suspected of sheltering behind Swiss secrecy laws'. Similarly, Justice Lehane of the Full Federal Court considered that it was an appropriate exercise of discretion to take into account whether an order might punish beneficial shareholders for their 'failure to make a disclosure which their nominees, but not (or anything that appears) they themselves had an obligation to make'.[40]

The judges did not explain what they meant by punitive measures. In the circumstances of this case the only relevant punishment would be the forced disclosure of the identity of the ultimate beneficial shareholder. By refusing to adopt an aggressive remedial order, Justice Sackville appears to have recognised that the clients of Swiss financial institutions have a legitimate right to financial privacy.[41] Since there was no evidence before him as to the motive of the beneficial shareholder,[42] he assumed that the undisclosed shareholder(s) were acting in good faith in relying on Swiss commercial secrecy laws.

The Federal Court also took into account the degree of culpability of the foreign nominees. Justice Sackville said that there was no evidence that Bank Leumi or EBC had 'acted dishonestly or in a manner that can be characterised as reckless'.[43] Similarly, Justice Lehane considered that the Swiss nominees had not acted in bad faith or with the deliberate object of circumventing Australian laws.[44]

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39 (1995) 18 ACSR 639 at 692, Sackville J considered that the maintenance of an informed market was one of the principal aims of the law, while the discovery of the ultimate beneficial owner was a 'subsidiary objective'.

40 (1996) 69 FCR 531 at 545; 139 ALR 527.

41 For an example of a US court recognising the legitimacy of Swiss commercial privacy, see *Minpeco SA v Conticommodity Services Inc* 116 FRD 517 at 524 (SDNY 1987).

42 (1995) 18 ACSR 639 at 689; 134 ALR 101.

43 Ibid, at ACSR 692.

44 (1996) 69 FCR 531 at 545. Justice Lehane distinguished the case of *North Broken Hill*

On one view, the enforcement remedy in the *OAP* case may be regarded as reasonable and proportional to the seriousness of the violation and the culpability of the financial intermediaries. It can hardly be said that non-compliance with a tracing notice is a serious offence compared with allegations of securities fraud or insider dealing. Culpability could not be assumed merely by the fact that the ultimate beneficial owners of the OAP shares were concealing their identities under Swiss secrecy laws. Furthermore, Australian courts, in contrast to some courts in the United States,[45] are not prepared to make a finding of bad faith on the basis of an assumption that a foreign financial institution must have knowledge of Australian corporate securities law requirements concerning shareholder disclosure and tracing notices.

On the other hand, the judicial view of culpability in the *OAP* case was based on very limited evidence which did not include any testimony from the Swiss financial institutions or cross examination of the Swiss bank expert evidence. For example, there was no evidence as to the Swiss nominee's knowledge of Australia's substantial shareholder disclosure laws and tracing notice requirements. This had the inevitable result that the Swiss nominee's claim of bona fides could not be forensically tested.

The relationship of Australian corporate securities requirements to foreign laws is a matter that was directly addressed by the courts in the *OAP* case. Justice Sackville gave considerable weight to Swiss secrecy laws in fashioning an appropriate remedy. The Full Federal Court rejected the view that the remedy ordered by Justice Sackville amounted to the giving of primacy to Swiss law over Australian law. The connections with Switzerland were substantial. Both Bank Leumi and EBC's conduct in complying with the ASC's tracing notices would require them to take action in Switzerland. That is, compliance by the Swiss financial institutions would require them to identify their clients by accessing their private banking network computers in Switzerland.

Australian courts give considerable weight to matters of international law and international comity. For example, the judicial remedy in the *OAP* case was consistent with the general principle of international law[46] that a State should moderate its enforcement jurisdiction where its law and the law of another State impose conflicting obligations on an individual. The balancing exercise conducted by Justice Sackville is one which courts in the United

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Holdings where there was evidence as to the identity of the beneficial shareholders and motives for refusing to give their nominees permission to disclose their identity; 139 ALR 527. In *North Broken Hill Holding* (1986) 10 ACLR 270 at 284, Fullagar J referred to the equitable owner of the secret share parcel as one who has 'deliberately set out to deceive the sharemarket, has deliberately set out to buy and has bought millions of shares on a market uninformed (and thus deceived), and has by so doing deliberately set out to flout in a very big way the spirit of the law'. His Honour went on to say that: '(IEL)'s intention in the end is likely to have been to buy NBH shares for less than they are intrinsically and potentially worth, or to sell them later on for more than their present price or both.'

45 See, eg, *SEC v Banca Della Svizzer Italianaa* 92 FRD 111 at 117–19 (SDNY 1981) where Judge Pollack assumed that the Swiss bank had acted in bad faith by 'invading American securities markets knowing that it would be relying on the non-disclosure laws of Switzerland'.

46 See American Law Institute, above n 31, para 442(1)(c).

States[47] and England[48] have utilised in dealing with the challenge of foreign nominees and foreign secrecy laws.

7 Business, legal and regulatory significance of the *OAP* judgments

What was the business outcome?[49] The unknown shareholders placed 9.29 million shares in OAP on the market at $2.84. There was a takeover contest for OAP which was won by the Independent Print Media Group, a joint venture between the Hannan and J B Fairfax families, with an offer of $2.72 a share, valuing the unknown Swiss share parcel at approximately $26.3 million.

It was reported in *The Financial Review*[50] that $26.3 million in proceeds from the sale were later frozen by the Australian Taxation Office (ATO) and finally became available for distribution, after payment of tax in 1997 under an ATO settlement. The net proceeds of the shares were then distributed to the Swiss financial institutions which presumably passed them to the secret shareholders.

In the *OAP* case there was no identification of the ultimate beneficial owner of a significant shareholding in an Australian listed company by using the tracing notice powers under the corporations legislation. This caused considerable disquiet to the corporate regulator as is shown by recent revelations. In 2003 ASIC launched a new investigation into the events of 1995 relating to the beneficial ownership of OAP, following reports in *The Financial Review*[51] that Swiss prosecutors in an unrelated matter had discovered the identity of the secret owners of OAP. The new ASIC investigation has involved a request by the Australian Government to the Swiss authorities for assistance based on an allegation that the secret shareholders committed perjury in Australia in 1995.[52] In 2006, newspaper reports[53] suggested that the ASIC had obtained Swiss bank records concerning the beneficial ownership of the OAP shares by relying on the 1991

47 See D Chaikin, 'Securities Laws and Extraterritoriality in the United States' in B A K Rider (Ed), *Regulation of the British Securities Industry*, Oyez, London, 1986, pp 174–88.

48 The English courts have applied a balancing approach but have also placed importance on the sovereignty of the foreign country and the legitimate interests of professional confidentiality. See, eg, *MacKinnon v Donaldson, Lufkin & Jenrette Securities Corp* [1986] 1 Ch 482 at 493–4; [1986] 1 All ER 653. See, generally, L Collins, *Essays in International Litigation and the Conflict of Laws*, Oxford University Press, 1997.

49 See M Kidman, 'Offset mystery deal', *The Age*, 15 December 1995; M Kidman, 'Swiss gnomes quitting Alpine', *Sydney Morning Herald*, 21 December 1995.

50 N Chenoweth, S Elam and R Graffagnini, 'Rivkin's Swiss bank scandal', *The Financial Review*, 29 October 2004.

51 S Elam and N Chenoweth, 'How a Zurich DA prised open Rene's secret world', *The Financial Review*, 29 October 2003.

52 ASIC Media Release 03-348, 'Offset Alpine Printing Group', 30 October 2003; Minister of Justice and Customs Press Release, 'Assistance sought from Swiss authorities on Rivkin probe', 30 January 2004.

53 J Garnaut, 'ASIC gets its hands on Rivkin's Swiss records', *Sydney Morning Herald*, 19 January 2006; J Garnaut, 'Rivkin's Swiss secret', *Sydney Morning Herald*, 19 January 2006. See also 'Swiss to send bank papers to Australia', *Swissmoney news*, 23 December 2005.

Australia/Swiss Mutual Assistance in Criminal Matters Treaty.[54]

The Australian corporate securities regulator has sought to play down the significance of its failure to penetrate foreign nominees by using the tracing powers. It has said[55] that no precedent has been established by the Federal Courts' decisions in the *OAP* case, and that individuals could not hide behind Swiss laws when buying Australian shares. This view may be tested by examining a number of cases that have occurred since the OAP judgments where the tracing powers have been used.

(i) *ASC v EBC Zurich AG (1995)*[56]

In 1995 the ASC obtained from the Federal Court orders freezing 3,680,000 shares in Allegiance Mining NL and Dome Resources NL for their failure to comply with the tracing and substantial shareholder provisions of the Corporations Law.[57] The two parcels of shares which were the subject of the freeze order were registered in the name of National Nominees on behalf of EBC Zurich AG, the Swiss finance company which had figured prominently in the *OAP* case.

In contrast to the *OAP* case, the proceedings in the *EBC* case were in substance not defended and no expert evidence was adduced as to the effect of Swiss law on a Swiss company complying with the particular requirements of the Australian Corporations Law. In these circumstances, Sackville J ordered:

- EBC to comply with the tracing notice and substantial shareholder notice obligations;
- that if EBC fails to comply with the orders, the shares should vest in the ASC until sold by it; and
- that the ASC is at liberty to decline to make any payments out of the proceeds of sale to any person claiming entitlement to the proceeds unless that person provides the information requested by the tracing notice.

Justice Sackville's orders in the *EBC* case were orders that his Honour had refused to grant in the circumstances of the *OAP* case. The reason for this appeared to be that the 'Swiss commercial secrecy defence' had not been raised in the *EBC* case, so that there was no issue whether the orders would compel EBC to violate Swiss law or whether such orders would amount to a 'punishment' of the secret shareholders.

In the upshot, EBC did not lodge substantial shareholding notices or comply with the tracing notices given to it by the ASC, as required by the orders of Justice Sackville. Instead, EBC entered into negotiations with the ASC as to the disposition of the matter and obtained new orders from the

54 For a discussion of the Swiss law on mutual assistance, see Chaikin, above n 26, and D Chaikin, 'Mutual Assistance in Criminal Matters: A Commonwealth Perspective', report published in the *Memoranda of the Meeting of the Commonwealth Law Ministers*, Commonwealth Secretariat, London, 1983.

55 M Kidman, 'ASC to act on "identity" problems', *Sydney Morning Herald*, 19 September 1997.

56 Unreported, FCA, Sackville J, NG3461/95, 14 December 1995, BC9501502.

57 ASC Media Release 95-139, 'Shares Frozen — Allegiance Mining NI and Dome Resources NL', 30 August 1995.

Federal Court to the effect that the sale of the parcel of shares in Allegiance Mining NL and Dome Resources NL be sold on or before 30 June 1997 and that the proceeds of the sale (after deduction of the costs of sale and the ASC costs) be transferred to EBC.

On 31 March 1997 EBC reached a settlement with the ASC[58] whereby EBC acknowledged to the Federal Court that it had breached the provisions of the Corporations Law, and gave an undertaking to the court that it would not in the future knowingly contravene the provisions of the Corporations Law. Under the settlement the ASC agreed to pay EBC the proceeds of the sale of the relevant share, in accordance with the Federal Court orders.

The terms of the settlement between the ASC and EBC have in theory imposed a new risk on EBC which may be held in contempt of court if it violates its undertakings to the court. As a practical matter this risk is minimal in that EBC is outside the jurisdiction of the Australian courts. There is also a possibility that any settlement agreement may be evaded. There is nothing to prevent EBC from using an associated legal entity to act as a foreign nominee for its clients so as to avoid the Australian corporations law.

(ii) *ASIC v Merkin Investments (2001)*[59]

In this case Bligh Ventures Pty Ltd (Bligh) became concerned as to the identity of a significant parcel of its shares in circumstances where it had become the subject of a takeover play. ASIC issued tracing notices under s 672A of the Corporations Law but was unable to discover the beneficial ownership of a 9.43% share parcel in Bligh. Eventually Merkin Investments Pty Ltd (Merkin), a Vanuatu registered holding company, filed a substantial shareholding notice and declared that it was the holder and beneficial owner of the Bligh shares.

The main issue in dispute was whether Merkin had continued to contravene the tracing notice requirements by failing to give proper disclose.[60] Under the Corporations Act, Merkin was obliged to disclose its knowledge of other person's relevant interests or other person's who have given instructions 'to the extent to which it is known'.[61] Merkin's statutory obligation was limited to its actual knowledge of those interests or instructions.

Merkin disclosed that its registered shareholders were Teak Ltd and Pine Ltd, both companies based in Vanuatu, while its directors were two corporate entities based in Vanuatu and Nauru. It contended that its registered shareholders were nominees for unknown third parties, so that it could not identify its own beneficial shareholders. It also claimed that it did not know the identity of the party or parties who gave instructions to purchase Bligh shares, and did not know the identity of the party or parties with whom its shareholders acted as bare trustees or nominees.

58 ASC Media Release 97-67, 'ASC settles Zurich proceedings', 25 March 1997; A Lampe, 'ASC gives up on the Swiss', *Sydney Morning Herald*, 26 March 1997.

59 (2001) 38 ACSR 648; 19 ACLC 1481.

60 Disclosure is required of the matters referred to in s 672B(1)(b) and (c) of the Corporations Act.

61 Section 672B(1A) of the Corporations Law provides that the person required to respond to the ASIC tracing notice need only disclose the requisite information 'to the extent to which it is known' to the person required to make the disclosure.

ASIC made a complex argument[62] which asserted that since Merkin must know the identity of its own 'directing mind and will', it must be in a position to know and therefore disclose the identity of its beneficial shareholders. The Supreme Court of Victoria did not accept ASIC's argument. Mandie J found that there was likely to be an ultimate client of Merkin, but that there was insufficient evidence to show that the client communicated directly to Merkin so that Merkin would know its identity. The court observed that:

> The client or clients may or may not be known to the corporate directors and shareholders of Merkin . . . the evidence does not enable the court to conclude that the knowledge of the unknown client or clients is the knowledge of Merkin. Evidence as to the chain of command or the precise relationships involved is not before the court and I am not satisfied, in the absence of such evidence, that knowledge of the identity of the person or persons having relevant interests (whom I have described as the client or clients) should be attributed to Merkin. Submissions were made in relation to the concepts of 'the directing mind and will' and the attribution of knowledge of that directing mind and will to the company, but it seems to me that the evidence here is insufficient to invoke those concepts.[63]

Although Merkin was not in continuous violation of the law, it had been in default. The Supreme Court refused to excuse Merkin for its past violation of the law because Merkin had failed to provide any satisfactory explanation as to why it had not complied with the Corporations Act.

Justice Mandie also held that the ignorance of a foreign nominee of its beneficiary client may provide a basis for a remedial order. His Honour ordered the Bligh shares to be vested in ASIC, the shares to be sold on public tender, and that, after deducting the costs of the sale and ASIC's costs on an indemnity basis, the residual proceeds be paid to the Australian nominee on behalf of Merkin.[64] His Honour refused to confiscate the profits of the shares because this would be 'unduly punitive'. This view echoes the opinion of Sackville J in the *Offset Alpine* case, where his Honour considered that the remedial orders should not be a form of punishment

Merkin may be viewed through two lenses. On one hand, it provides another illustration of the ineffectiveness of the tracing notice provisions to discover the ultimate beneficial owner of an Australian listed company. It shows that a foreign nominee may make corporate arrangements so that it can claim ignorance of the identity of its clients who have relevant interests in shares of an Australian company. On the other hand, the beneficial owners of Merkin paid a price for their non-disclosure in that they were not allowed to keep their shareholding interest, which may have been very important if the purpose of the secret shareholding was to obtain control of the corporation. It is not clear whether the order to pay indemnity costs would deprive the ultimate beneficial owners of Merkin of their profits in holding shares in Bligh.

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62 ASIC's argument was based on a long line of inferences which if accepted in their entirety would suggest that on the balance of possibilities Merkin must know the identity of its beneficial shareholder. See (2001) 38 ACSR 648 at 656–7.

63 Ibid, at 658.

64 ASC Media Release 01-268, 'Supreme Court vests Bligh Venture shares in ASIC', 2 August 2001.

(iii) *In the Matter of the Village Roadshow Ltd (2004)*[65]

In this case the Takeovers Panel (Panel), applying the principles set out in the judgments in the *OAP* case, held that Swiss bank secrecy laws did not relieve two Swiss banks, Schroders AG and Swissfirst AG, from their obligations to comply with a tracing notice issued by Village Roadshow Ltd under s 672B of the Corporations Act. The Panel gave the Swiss banks another opportunity to identify their clients, but they refused to do so, relying on Swiss bank secrecy. The Panel held that the continuing contraventions of the tracing notice requirements by the two Swiss banks and 001Invest World Currency Fund Ltd of Bermuda, which in 'aggregate' concerned 10.2% of the total number of ordinary shares in Village Roadshow, resulted in the market being misinformed, and were sufficient to constitute 'unacceptable circumstances'.[66]

The Panel made final orders that the undisclosed shareholdings in Village Roadshow be vested in ASIC, and then sold on an orderly basis by an independent broker, with the proviso that none of the shares be sold to their previous owners or associates.

It was reported[67] that in May 2004 Deutsche Bank, as the ASIC appointed broker, had sold the secret parcel of 23.9 millions shares for $A41 million which was distributed to the Swiss banks and the Bermudian company, after the deduction of the costs, fees and expenses of the sale, including those incurred by ASIC in complying with the Panel's orders.

The Panel in its annual report[68] has contended that the decision in the *Village Roadshow* case illustrates the effectiveness of the sanctions powers available to the Panel. This contention assumes that the beneficial owners of the shares in Village Roadshow were interested in continuing to maintain their investment in the company. However, the secret shareholders in Village Roadshow were dissatisfied with the company and its proposal to buy back $360 million of preference shares. The outcome was that the secret shareholders were able to maintain their anonymity and to retrieve their investment with profits intact.

It appears that the sanctions imposed for contraventions of Australian corporate law have had little deterrent effect[69] on the behaviour of Swiss

65 *In the matter of Village Roadshow Ltd* [2004] ATP 4 (12 February 2004). See website of the Takeovers Panel: <http://www.takeovers.gov.au>.

66 Section 657A(1)–(3) of the Corporations Act sets out the circumstances in relation to the affairs of a company which the Panel may declare to be 'unacceptable circumstances'. The circumstances are: '(a) unacceptable having regard to the effect of the circumstances on: (i) the control, or potential control, of the company or another company; or (ii) the acquisition, or proposed acquisition, by a person of a substantial interest in the company or another company; or (b) are unacceptable because they constitute, or give rise to, a contravention of this Chapter (6) or of Chapter 6A, 6B or 6C.' See also Panel Guidance Note 1, Unacceptable Circumstances.

67 See 'Australia sells shares held by Swiss banks', *Swissmoney news*, 14 May 2004.

68 Review by the President of the Takeovers Panel, *The Year Ahead*, Annual Report, 2004.

69 See the statement by Fullagar J in *Re North Broken Hill Holdings Ltd* (1986) 10 ACLR 270 at 286: the court is empowered to make any order 'calculated to conduce to the attainment of purchases on an informed market or calculated to set aside now and discourage in the future purchases made on an uninformed market'. See also judicial statements that the remedies may be designed to prevent defaulters from enjoying the benefits of their contraventions: *National Companies & Securities Commission v Monarch Petroleum NL*

financial institutions. For example, one of the defaulting Swiss banks in the *Village Roadshow* matter in 2004 was Swissfirst Bank which has a direct connection with EBC Zurich. The latter Swiss finance company had agreed in 1995 not to contravene Australian corporate law as part of its settlement with ASC. Swiss corporate records[70] reveal that in 1995 EBC Zurich was a subsidiary of the Swiss private bank August Roth AG. In late 1999 the Swissfirst group acquired August Roth AG renamed it Swissfirst Bank and then deregistered EBC Zurich.

(iv) *In the Matter of the Gribbles Group Ltd (2004)*[71]

In this case ASIC applied to the Panel for a declaration of unacceptable circumstances because of alleged breaches of the tracing and substantial holding provisions of the Corporations Act by parties associated with EC Medical Investments NV (ECMI). ECMI was a Dutch company which had a 43.1% shareholder stake in Gribbles Group Ltd (Gribbles).

ASIC's enforcement action precipitated the disclosure of the underlying beneficial shareholders in Gribbles. On 16 July 2004, seven days after ASIC's application to the Panel, various foreign trusts and foreign companies filed notices as substantial holders of shares in Gribbles while ECMI lodged a notice of change of interests of a substantial holder. These disclosures showed that ECMI was controlled by a web of foreign companies and trusts for the benefit of the children of Mr Wallace Cameron, the chairman and chief executive officer of Gribbles. Subsequently, the Panel[72] consented to the withdrawal of ASIC's application on the basis that the alleged unacceptable circumstances had been remedied by ECMI's disclosures. In the meantime, ASIC launched an investigation into the adequacy of the notices filed by ECMI and the other shareholders.

In ASIC's media release[73] the corporate regulator stated that its strategy in making an application to the Panel was to seek an order vesting the Gribbles share parcel in it 'in the event that the ultimate owners of that parcel are not disclosed to the market'. There is an ambiguity in this statement in that it might suggest that ASIC is seeking the permanent vesting of the shares or the proceeds of those shares. However, the Panel's powers to make orders under s 657D are less extensive than the court's powers to make orders under s 1325A of the Corporations Act. Although the Panel has the power to issue remedial orders, which includes vesting shares in ASIC, this can only be done if the Panel considers it appropriate for one of the purposes spelt out in

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[1984] VR 733 at 741 per Nicholson J; *ASC v Mt Burgess Gold Mining Co NL* (1994) 62 FCR 389 at 394–5 per Lee J; 15 ACSR 714; *Gjergja & Atco Controls Pty Ltd v Cooper* [1987] VR 167 at 215–16 per Ormiston J; *ASIC v Terra Industries* (1999) 92 FCR 257; 163 ALR 122 per Merkel J.

70 Public records of the Swiss companies were examined by the author on 10 February 2005.

71 *In the Matter of the Gribbles Group Ltd* [2004] ATP 15 (27 July 2004).

72 Takeovers Panel Media Release, 'The Gribbles Group Limited: Panel Accepts undertaking', 16 July 2004; Takeovers Panel Media Release, 'The Gribbles Group Limited: Panel consents to withdrawal of application by ASIC', 21 July 2004.

73 ASIC Media Release 04-222, 'ASIC refers Gribbles shareholder to Panel', 9 July 2004; ASIC Media Release 04-235, 'ASIC investigates Gribbles shareholder', 20 July 2004.

s 657D(2).[74] A key purpose for making a remedial order is to 'protect the rights or interests of any person affected by the (unacceptable) circumstances'.

The *Gribbles* case provides an illustration of the factual circumstances where enforcement action by ASIC is likely to be effective against a foreign nominee. This case is different from the *OAP* case in that the main commercial priority of the secret shareholders in Gribbles was to maintain their investment stake for the purpose of mounting a management buy-out. The vesting of the shares in ASIC would have destroyed this commercial priority. The underlying beneficial shareholders in Gribbles were prepared to provide disclosure even if this had other adverse commercial and tax consequences.[75] In November 2004 Mr Cameron sold the family stake in Gribbles for $121 million after a successful takeover of Gribbles by rival Healthscope.

8 Sanctions and strategic enforcement

Under the theory of strategic enforcement the regulator may use a mixture of enforcement options to secure compliance and deter violations of the law. One idea that has become well accepted is the model of pyramid enforcement[76] whereby the regulator may escalate the sanctions in order to encourage compliance with statutory obligations.

Contraventions of the substantial shareholder disclosure and tracing notice requirements give rise to various sanctions under the Corporations Act. There are a range of enforcement options including the imposition of criminal and civil penalties, civil claims for compensation, and remedial orders that may be issued by a court or the Panel.

Criminal sanctions may be viewed as near the top of a pyramid of enforcement options. Although a criminal contravention of the substantial shareholder or tracing notice provisions is not too difficult to prove in that the offence is one of strict liability,[77] it is virtually unknown for a criminal prosecution to take place. In the case of a foreign nominee, there is an additional problem of securing criminal jurisdiction over an accused person who is located in a foreign country. If the accused does not voluntarily submit

74 The Panel may make any order (including a remedial order but not including an order directing a person to comply with a requirement) that it thinks appropriate to:

(a) protect the rights or interests of any person affected by the circumstances; or (b) ensure that a takeover bid or proposed takeover bid in relation to securities proceeds (as far as possible) in a way that it would have proceeded if the circumstances had not occurred; or (c) specify in greater detail the requirements of an order made under this subsection; or (d) determine who is to bear the costs of the parties to the proceedings before the Panel.

75 R Urban, 'Tax probe includes Cameron companies', *Sydney Morning Herald*, 1 November 2004. See also <www.gribbles.com.au> (accessed 10 October 2005).

76 See I Ayres and J Braithwaite, *Responsive Regulation: Transcending the Deregulation Debate*, Oxford University Press, New York, 1992; H Bird, D Chow and I Ramsay, *ASIC Enforcement Patterns*, Centre for Corporate Law and Securities Regulation, University of Melbourne, 2002.

77 Corporations Act 2001 s 671B(1A) (substantial holding information), s 672B(1B) (tracing notice). See also s 1311 and Sch 3. In relation to a tracing notice offence, a defendant also bears an evidential burden in relation to matters in s 672B(1A) (that is, the knowledge requirement in respect of other person's relevant interests). See also s 13.3(3) of the Criminal Code.

to jurisdiction, the Australian authorities will consider extradition. However, extradition is not permissible under Australia's extradition law and treaties in that the substantial shareholding and tracing notice offences are punishable for less than the statutory minimum requirement, namely, 12 months imprisonment.[78]

Other sanctions do not appear to be effective against foreign nominees. For example, ASIC may seek the imposition of civil penalties for contraventions of the substantial shareholder notice or tracing notice requirements. The civil penalty regime requires ASIC to prove its case on the balance of probabilities. This may provide some deterrence to local nominees, but it has no practical application to foreign nominees who have no assets in Australia.

There is also the possibility of a party seeking damages for losses suffered as a result of contravening the substantial holder disclosure[79] or tracing notice requirements[80] of the Corporations Act. In securing a civil remedy there is the problem of proving loss or damages. In the case of foreign nominees, there are the additional difficulties of service of process out of jurisdiction and enforcing a judgment against a party which has no assets in Australia.

The notion that enforcement remedies may be strategically escalated does not work in the case of foreign nominees which contravene the tracing notice requirements. In practice ASIC has only one 'effective gun' against recalcitrant foreign nominees, that is to apply for one of the judicial remedies under Ch 6 of the Corporations Act. The most severe sanction which the court may impose is the vesting of the shares or interest in the shares in ASIC.

In theory the vesting of the shares provides the greatest deterrent against breach of the law by foreign nominees in that it may amount to a confiscation of the shares themselves.[81] The courts have rarely vested the shares absolutely in a corporate securities enforcement case[82] and, as the *OAP* case illustrates, the courts will invariably require ASIC to return the proceeds of the sale of the shares to the foreign nominee. Indeed, it is difficult to envisage any circumstance where the court would confiscate a shareholder's investment even for the most flagrant and deliberate violation of the substantial shareholder or tracing notice laws.

9 Conclusions and recommendations

ASIC's tracing powers are subject to serious limitations in ascertaining the ultimate beneficial owners of listed companies in Australia. The *OAP* case demonstrates that the tracing powers in the Corporations Act are ineffective in

78 See the definition of 'extradition offence' in s 5 of the Extradition Act 1988 (Cth).

79 Corporations Act 2001 s 671C.

80 Corporations Act 2001 ss 671C and 672F.

81 For a discussion of confiscation of shares for substantial shareholder violations, see D Chaikin, 'Cracking the Nominee in New Zealand' (1988) 8 *Commonwealth Law Bulletin* 814.

82 See, eg, the exceptional case of *Re North Broken Hill Holdings Pty Ltd* (1986) 10 ACLR 270 where Fullagar J vested a parcel of 21.4 millions shares (valued at approximately $65 million) in the National Companies and Securities Commission. The shares were to be sold over a six month period and the proceeds paid to the government. This decision was reversed on appeal by the Full Federal Court on the ground that the tracing notice did not strictly comply with the prescribed legislative form: See *Crosley Ltd v North Broken Hill Holdings Ltd (No 2)* [1987] VR 119.

identifying beneficial holders where the nominee is located overseas in a secrecy jurisdiction. If the foreign nominee refuses to comply with a tracing notice, there are few options available to unmask the secret shareholders.[83] This enforcement gap may encourage foreign nominees to be used in the avoidance of the substantial shareholder disclosure requirements.

The remedies that the courts and the Takeovers Panel have applied to uncooperative foreign nominees have had no deterrent effect in cases where the beneficial shareholders' desire for secrecy is the highest priority. However, recalcitrant foreign nominees face the risk that their clients may lose entitlement to maintain their shareholding if they do not comply with a tracing notice. The sanction of disgorgement of shares will ensure that the hidden ownership of Australian listed companies cannot be maintained. The regulatory technique of tracing notices is likely to be most effective in preventing a secret shareholder from unlawfully taking control of an Australian listed company. This furthers the strategic policy goal of maintaining a fully informed market, especially in the context of takeovers.

Given the widespread use of nominees in Australia's capital markets, there is no easy solution in dealing with foreign nominees who contravene Australian corporate law. One preventative strategy would be to impose new statutory obligations on a registered shareholder whenever that shareholder acquires an interest on behalf of another person, including a non-resident. The registered shareholder may be required to inform the other person of Australian corporate regulatory requirements, including those pertaining to substantial shareholdings disclosure and tracing notices. If this was a prescribed requirement, ASIC may be in a stronger position to challenge the bona fides[84] of the foreign nominee and its client.

Another proposal would be for the legislature to specifically empower the courts to freeze the shares or proceeds of shares held on behalf of a foreign nominee until there was compliance with the tracing notice. This was the remedy that ASC failed to obtain in the *OAP* case. Given the wide judicial discretion in this area, it is doubtful whether the courts would impose this remedy without further legislative guidance. This raises the question whether the Parliament should expressly declare in the Corporations Act that foreign secrecy laws are inimical to Australian interests and that the courts should ignore foreign privacy laws when moulding judicial remedies. This proposal has serious implications for Australia's international relations, international comity and the rights of financial privacy. Further study is required as to the impact of foreign secrecy laws on Australian corporations legislation before the enactment of any such proposal.

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83 The main option is to apply to the foreign country for assistance in identifying the beneficial shareholder for the purpose of a criminal investigation. This will usually be done through a mutual assistance request based on a treaty.

84 See statement of Lehane J in the *OAP* case (1996) 69 FCR 531 at 546; 139 ALR 527:

> A nominee company which is fully aware of the requirements of Australian law and of the remedies available for breach may not evoke much sympathy if it persists in a practice of acquiring shares on behalf of clients without obtaining instructions which would permit disclosure of their identity if required.