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By online submission form

Dear Australian Law Reform Commission

Submission – Financial Services Legislation: Interim Report A (ALRC Report 137, 2021)

1 Introduction

This submission is made by Herbert Smith Freehills (**HSF**) in response to the Australian Law Reform Commission (**ALRC**) report, *Financial Services Legislation: Interim Report A* (Report 137, 2021) (**Interim Report**), which was tabled in Parliament by the Attorney-General of Australia on 30 November 2021.

Proposal A20 proposes to clarify the meaning of the phrase ‘efficiently, honestly and fairly’ in section 912A(1)(a) of the *Corporations Act 2001* (Cth) (**Corporations Act**) by:

- (a) separating the words ‘efficiently’, ‘honestly’ and ‘fairly’ into individual paragraphs so that each term in that composite phrase imports a standalone obligation;
- (b) replacing the word ‘efficiently’ with ‘professionally’, in accordance with the meaning established by case law; and
- (c) inserting an explanatory note containing examples of conduct that would fail to satisfy the ‘fairly’ standard.

We are grateful for the opportunity to submit a response to these proposals, and we wish to address proposals A20(a) and (b) in this submission.

HSF is an international law firm with 27 offices located around the globe and which specialises in, amongst other things, financial services and financial services regulation. We have closely followed the developments in respect of the interpretation of the phrase ‘efficiently, honestly and fairly’.

In our view, the treatment of the terms ‘efficiently’, ‘honestly’ and ‘fairly’ as creating standalone obligations is consistent with recent trends in the case law. This recent shift in case law has given rise to considerable ambiguity across the industry and accordingly, we welcome legislative clarification in this regard.

However, with respect to proposal A20(b), we submit that the best replacement of the term ‘efficiently’ is ‘competently’, rather than ‘professionally’.

2 Standalone obligations (Proposal A20(a))

As the ALRC noted in its Interim Report, conflicting case law has made it unclear whether the terms in the phrase ‘efficiently, honestly and fairly’ are to be understood in composite or as standalone obligations. However, there is, in our view, a clear trend in the contemporary case law supporting the view that the ‘efficiently, honestly and fairly’ obligation comprises three standalone obligations.



In *Australian Securities and Investment Commission v Westpac Securities Administration Ltd* (2019) 272 FCR 170, Allsop CJ stated (at [170]):

The phrase [efficiently, honestly and fairly] has been held to be compendious as a single composite concept, rather than containing three discrete behavioural norms. That said, if a body of deliberate and carefully planned conduct can be characterised as unfair, even if it cannot be described as dishonest, such may suffice for the proper characterisation to be made.

As the ALRC noted, the Chief Justice reserved the question of whether the phrase is compendious for another occasion where the issue could be fully argued. O'Bryan J more firmly rejected the compendious view, stating (at [426]):

*...it seems to me that there is no reason why it cannot carry its ordinary meaning which includes an absence of injustice, even-handedness and reasonableness. As is the case with legislative requirements of a similar kind, such as provisions addressing unfair contract terms, the characterisation of conduct as unfair is evaluative and must be done with close attention to the applicable statutory provision: cf *Paciocco v Australia and New Zealand Banking Group Ltd* (2015) 236 FCR 199 at [364]. It seems to me that the concepts of efficiently, honestly and fairly are not inherently in conflict with each other and that the ordinary meaning of the words used in s 912A(1)(a) is to impose three concurrent obligations on the financial services licensee: to ensure that the financial services are provided efficiently, and are provided honestly, and are provided fairly.*

Following the decision in *Australian Securities and Investment Commission v Westpac Securities Administration Ltd* (2019) 272 FCR 170, judges of the Federal Court have taken differing approaches to the scope of the obligation.

In *Australian Securities and Investments Commission v AGM Markets Pty Ltd (in liquidation) (No 3)* (2020) 275 FCR 57 at [506], Beach J reverted to the previous historical and conventional judicial interpretation, holding that the words 'efficiently, honestly and fairly' are to be read as a compendious 'indication requiring a licensee to go about their duties efficiently having regard to the dictates of honesty and fairness, honestly having regard to the dictates of efficiency and fairness, and fairly having regard to the dictates of efficiency and honesty'. His Honour referred to these principles again in *Australian Securities and Investments Commission v Commonwealth Bank of Australia* [2020] FCA 790 at [50].

More recently in *Australian Securities and Investments Commission v MobiSuper Pty Ltd* [2021] FCA 855, Jackson J adopted a somewhat 'hybrid' approach, by making an assessment of the obligation both as a compendious obligation and as three separate obligations. However, significantly, his Honour described the breach in terms of the fairness and honesty elements, ignoring the efficiency element even when applying the singular test. Following the approach taken by Allsop CJ in *Australian Securities and Investment Commission v Westpac Securities Administration Ltd*, his Honour said (at [49]):

The issue of interests in the MobiSuper Fund in those circumstances would not have been provided 'efficiently, honestly and fairly', considered as a compendious term and (at least) not honestly and not fairly, considered as separate concepts...But his Honour's words do capture the essence of the lack of honesty, fairness and sound ethical dealing which would have occurred in the present case if the risks I have described had come to pass.

In *Australian Securities and Investments Commission v RI Advice Group Pty Ltd (No 2)* [2021] FCA 877, despite noting that it was unnecessary to resolve the question of whether 'efficiently, honestly and fairly' is a compendious expression, Moshinsky J found that RI Advice had breached the obligation by failing to have adequate compliance,



monitoring and supervision frameworks in place to ensure financial advice was being provided appropriately. That is, his Honour appeared to premise the breach on the respondent's failure to satisfy the 'efficiency' limb, despite an absence of the form of morally culpable conduct that is contemplated by the standards of honesty and fairness.

These developments are indicative, in our view, of a judicial trend whereby the Federal Court is prepared to apply the 'efficiently, honestly and fairly' obligation in a malleable way, which is not limited by compendious interpretation. Proposal A20(a) is consistent with this trend. Given the recent uncertainty across industry that has arisen due to this shifting judicial trend, we welcome any clarification of the scope of the 'efficiently, honestly and fairly' obligation.

3 The 'efficiency' limb (Proposal A20(b)) – 'Competently' vs 'Professionally'

We submit that the word 'efficiently' should be replaced with the word 'competently'.

At paragraph [13.73] of its Interim Report, the ALRC suggests that 'professionally' or 'professionalism' as referred to in section 760A(b) ('fairly, honestly and professionally') and the general objects of Chapter 7 should be adopted in section 912A instead of 'efficiently.'

We respectfully submit that, consistently with the ALRC's stated objective at paragraph [13.71] of the Interim Report, 'competently' would better accord with the meaning that has been attributed to the word 'efficiently' by the courts, including in the following cases:

Australian Securities and Investments Commission v Camelot Derivatives Pty Ltd (in liq) (2012) 88 ACSR 206

Having regard to Young J's comments concerning the meaning of the phrase 'efficiently, honestly and fairly' in *Story v National Companies and Securities Commission* (1988) 13 NSWLR 661, Foster J accepted that '[t]he words "efficiently, honestly and fairly" connote a requirement of **competence** in providing advice and in complying with relevant statutory obligations...The word "efficient" refers to a person who performs his duties efficiently, meaning a person is adequate in performance, produces the desired effect, is capable, **competent** and adequate' (at [69], emphasis added).

Australian Securities and Investments Commission v Avestra Asset Management Ltd (In Liq) (2017) 348 ALR 525

Beach J said that the phrase 'efficiently, honestly and fairly' 'connotes a requirement of **competency** in providing advice and in complying with relevant statutory obligations...the word "efficient" entails that the person is adequate in performance and is **competent**' (at 561, emphasis added).

Australian Securities and Investments Commission (ASIC) v AGM Markets Pty Ltd (In Liq) (No 3) (2020) 275 FCR 57

Similarly, in this case, Beach J adopted the words of Young J in *Story v National Companies and Securities Commission* (1988) 13 NSWLR 661 (see below), stating that 'the word "efficiently" refers to a person who performs his duties efficiently, meaning the person is adequate in performance, produces the desired effect, is capable, **competent** and adequate. Inefficiency may be established by demonstrating that the performance of a licensee's functions falls short of the reasonable standard of performance by a dealer that the public is entitled to expect" (at [508], emphasis added).



Australian Securities and Investment Commission v Westpac Securities Administration Ltd (2019) 272 FCR 170

O'Bryan J read the term 'efficiency' to mean '**competent**, capable and having and using the requisite knowledge, skill and industry' (at [426], emphasis added).

This is despite O'Bryan J expressly acknowledging (at [397]) that the purpose of Chapter 7 is, broadly, to promote 'fairness, honesty and **professionalism**' by those who provide financial services' (emphasis added).

In his Honour's view, 'competent' was 'the meaning well adapted to the statutory provision' itself (at [426]).

It is worth noting that section 912A(1)(a) was introduced by the *Financial Services Reform Act 2001* (Cth), and under the original draft of the Financial Services Reform Bill 2001 (Cth), the provision only required that financial services be provided 'competently and honestly'. As Gleeson J noted in *Australian Securities and Investments Commission v Westpac Securities Administration Ltd* (2018) 133 ACSR 1 at [413], the wording was replaced with the phrase 'efficiently, honestly and fairly' to reflect the equivalent provision in the predecessor Act, the *Corporations Law* (Cth). The Supplementary Memorandum to the *Financial Services Reform Bill 2001* (Cth) stated (at [3.74]):

Paragraph 912A(a) currently obliges licensees to provide services 'competently and honestly'. It is proposed to amend this paragraph to require licensees to provide services 'efficiently, honestly and fairly' (in line with the wording of the licensing obligations in Parts 7.3 and 8.3 of the current Corporations Law) (see proposed item 64).

As Gleeson J recognised (at [416]), the term 'efficiently, honestly and fairly' in Parts 7.3 and 8.3 of the Corporations Law appears to have had its origin in section 60 of the Security Industry (New South Wales) Code, which enabled the National Companies and Securities Commission to revoke a dealer's licence if the Commission had reason to believe a licence holder 'has not performed the duties of a holder of such a licence efficiently, honestly and fairly'.

In *Story v National Companies and Securities Commission* (1988) 13 NSWLR 661, Young J considered the meaning of 'efficiently, honestly and fairly' within the meaning of the Code. His Honour said that 'someone is an efficient person or performs his duties efficiently if he is adequate in performance, produces the desired effect, is capable, **competent** and adequate' (at 672, emphasis added). At the licensee level, his Honour considered that 'inefficiency' would be established by demonstrating that the performance of the licensee's functions fell short of the reasonable standard of performance objectively expected of them (at 679).

In adopting the phrase 'efficiently, honestly and fairly', the legislature imported the concepts of 'adequacy' and 'competence' into section 912A(1)(a) of the Corporations Act, and as is evident in the list of cases above, Young J's construction has been applied repeatedly in the context of section 912A(1)(a).

The current statutory framework in Chapter 7 of the Corporations Act is otherwise already familiar with the term 'competence'. It is used in respect of the standards expected of financial services licensees under subsections 912A(1)(e) and 912A(1)(f) of the Corporations Act. By contrast, the standard of acting 'professionally' is not used at all to set the normative standard for any obligation in Chapter 7 of the Corporations Act. We therefore consider that the term 'professionally' will introduce additional uncertainty into this regime through the introduction of a new concept of conduct.

It must also be noted that the standard expected under section 912A(1)(a) is a sliding scale, the content of which varies according to the nature, scale and complexity of the licensee. This has been emphasised by ASIC in Regulatory Guide 104 *AFS licensing*:



Meeting the general obligations. The standard of 'competence' is intuitively less fixed than one of 'professionalism' and therefore accords with this characteristic of section 912A(1)(a).

Moreover, if, as is proposed, the standard of 'professionalism' is to be construed as a standard of independent force, it may attract civil penalty provisions for a trivial dereliction of duty, or an immaterial breach of a code of 'professionalism'. Using 'competency' as the yardstick would mean that a breach must involve conduct that is incompetent, which seems to be a more reasonable basis for invoking and justifying a civil penalty provision. The term 'competency' also houses sufficient fluidity to afford a court some degree of discretion to treat lower level dereliction as something less than incompetency.

Thank you for providing us the opportunity to comment on the Interim Report. If you would like to discuss the matters raised in this submission, please contact Michael Vrisakis or Fiona Smedley using the details below.

Yours sincerely

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