

Case review: ASIC v Adler [2002]

University

CASE REVIEW: ASIC V ADLER [2002]

Name

ID

Unit Title

Code Number

Lecturer's Name

Table of content

Introduction.....	3
Discussion.....	3
Inappropriate corporate behaviour exhibited by Adler.....	3
Conflict, risen by Adler's behaviour with Australian law.....	4
Punishment suffered by Adler due to the conviction.....	6
Lessons concerning management of Australian companies acquired from this case.....	7
Relative observations.....	8
Conclusion.....	8
Reference list.....	9

Introduction

The ASIC v Adler [2002] case concerns with the alleged contravention of Corporation Law of Australia by the four defendants Mr Adler, a shareholder and non-executive director of HIH; Mr Williams the founder and CEO of HIH, Mr Fodera; a director and CFO of HIH and Adler Corporation Pty Ltd¹. The plaintiff, that is, Australian Securities and Investment Commission (ASIC) for this case has presented the instance of nine transactions undertaken by the defenders for pointing put the contraventions of corporate law, more specifically Corporations Act 2001 that have been performed in this case. These transactions were identified as the reason for misleading the shareholders of HIH, concerning the value of the company². This case serves as an example for the duties and responsibilities of the directors and officials of a business organisation operating within Australia and the consequence of overlooking them.

Discussion

Inappropriate corporate behaviour exhibited by Adler

The plaintiff, ASIC has used the evidence of nine transactions undertaken by the four defenders, especially the first defender Mr Adler and fourth defender Adler Corporation Pty Ltd, which is owned by Mr Adler. The first among the nine transactions was the advance payment of \$10 million by HIHC, which is a solely owned subsidiary of the HIH, to Pacific Eagle Equity Pty Ltd. (PEE), in response to the request of Mr Adler³.

The second and third defendants were accused of making this payment possible on behalf of the HIH Casualty and General Insurance Ltd. PEE is the company, established by Mr Adler to perform beneficial business and investment for HIHC. Within the period of following two weeks, beginning from 15 June 2000, Mr Adler through PEE purchases shares of HIH, worth \$3,991,856.21 to stabilise the share price of HIH to maintain the value of his personal own shares of the organisation, by projecting the impression that he is supporting the organisation in

¹ Adams, M., (2011). Latest developments in officers' duties of SMEs, *Journal of Business Systems, Governance and Ethics*, 6(3), p.31

² Golding, G., (2012). Tightening the screws on directors: Care, delegation and reliance, *UNSWLJ*, 35, p.266

³ *ASIC v Adler* [2002] ASIC v Adler [2002] NSWSC 171 ACLC 576 2753/01 2753/01 (Supreme Court of New South Wales Equity Division), p.4

Case review: ASIC v Adler [2002]

the market. Subsequently, on 20 September 2000, Mr Adler, through AEUT, sold these shares at the loss of \$2,121,261.11. Australian Equity Unit Trust (AEUT) was a trust established by executing a Trust Deed in which PEE was the trustee.

The third, fourth and fifth transactions were performed between 25 August and 26 September 2000 using the payment of \$10 million acquired from HIH. In these three transactions, Adler enabled AEUT to purchase three investments in unlisted technologies from Adler Corporation. These transactions included the acquisition of shares from dstore Limited (\$500,002), Planed Soccer International Limited (\$820,748) and Nomad Telecommunication Limited (\$2,539,000) for which AEUT suffered the loss of \$3,859,002⁴. These transactions served as the foundation for a claim of breach of directorial duties against Mr Adler as well as the Adler Corporation as Mr Adler failed to act responsibly as a director of neither HIH nor AEUT during these transactions.

The sixth to ninth transactions include the issue of unsecured loans issued by AEUT between 26 July 2000 and 30 July 2000 that cost \$2,084,345 to the organisation. Ms Adler during these transactions allegedly enabled AEUT to provide unsecured loans to Morehuman Pty Ltd worth \$160,000, to Intagrowth Fund No 1 worth \$500,000, to Pacific capital partners worth \$200,000 and finally to PCP Ensor No. 2 Pty Ltd worth \$1,275,475⁵. This clearly marks the failure of Mr Adler as a director of the AEUT and hence of HIH as the payment acquired from HIH worth \$10 million was invested in the operations of AEUT as well.

Conflict, arisen by Adler's behaviour with Australian law

The first transaction as discussed in the section above contravenes the section 208 of the Corporations Act 2001, which marks that for assigning financial benefit to a particular member of a corporate entity approval or consent of the other members is needed⁶. However, as per the record, no evidence of formal approval has been produced in part of the defendants from the

⁴ *ASIC v Adler* [2002] ASIC v Adler [2002] NSWSC 171 ACLC 576 2753/01 2753/01 (Supreme Court of New South Wales Equity Division), p.6

⁵ *ASIC v Adler* [2002] ASIC v Adler [2002] NSWSC 171 ACLC 576 2753/01 2753/01 (Supreme Court of New South Wales Equity Division), p.4

⁶ *Corporations Act 2001* (Cth) s208

Case review: ASIC v Adler [2002]

board of directors. This also avails the base for conviction of the four defendants under section 209(2) as per which the defendants as especially the first defendant are subject to penalty⁷.

The second transaction, which refers to the transaction, undertaken by AEUT contravenes the section 260D (2) of the Corporations Act 2001, which is the consequence of breaching the section 206A of the same⁸. Section 206A (1) (a) (i) states that a company might issue financial support to an individual for acquiring the organisational share if it does not hamper the interest of its shareholders⁹. Therefore, the defendants as per the subsection 2 are subject to the provision of the civil penalty. In this transaction, Mr William, as the CEO of HIH is subject to the contravention of section 182 of the Corporations Act which instructs that the director or other officers of a business organisation must not utilise their position inappropriately for generation profit for oneself or someone else¹⁰. Mr Adler possesses accessory liability for this offence as well.

For the third to the fifth transaction, Mr Adler was found contravening his directorial duties as under section 108, which instructs the individuals that hold the position of director or officer in a business corporation to exercise their power as well as discharge their responsibilities with a reasonable amount of care and diligence. The repeated failure in part of Mr Adler in ensuring the benefit of the companies such as HIH and AEUT makes him subject to breach of this section of the Corporations Act 2001. However, Adler Corporation has been found responsible for the contravention of the section 181(2), 182(2) as per these pieces of Australian legislation the director or the responsible authority need to exercise their power for proper reason in interest of the corporation and restraining inappropriate use of their power which has clearly been breached in the given case¹¹. Moreover, Mr Adler and Adler Corporation has contravened section 183 of the Corporations Act 2001 Mr Adler along with Adler corporation has used the organisational information for generating false impression about HIH in the market and among the shareholders¹².

⁷ *Corporations Act 2001* (Cth) s209(2)

⁸ *Corporations Act 2001* (Cth) s260D

⁹ *Corporations Act 2001* (Cth) s206A

¹⁰ *Corporations Act 2001* (Cth) s182

¹¹ *Corporations Act 2001* (Cth) s181

¹² *Corporations Act 2001* (Cth) s183

Case review: ASIC v Adler [2002]

The plaintiff ASIC pointed out the sixth, seventh eighth and ninth transaction as the basis for the claim against Mr Adler and Adler Corporation regarding breach of directorial duties as per section 180 and 181 of Corporations Act 2001. As per the section 180, a director of a business organisation has to exercise own power in a manner in which a reasonable individual would do so, which has clearly been breached in the sixth to ninth transactions¹³. On the other hand, section 181 states that the decisions of a director of the corporation need to solely be driven by the interests of the business organisation¹⁴. As a director and officer of HIH and responsible decision maker of AEUT, it was the responsibility of Mr Adler to take the financial decisions for generating maximum value for these organisations. In contrary, issuing the unsecured loans made the organisational assets subject to considerable risk, therefore, section 181 has been breached here.

Punishment suffered by Adler due to the conviction

From the discussion above, it is evident that several sections of the Corporations Act 2001 have been contravened in the particular case, while Mr Adler has been found responsible for the majority of them. Therefore, the ASIC has sought three punishments for the first defendant, including disqualification from the responsibility of managing corporations as per the section 206C and 206E, compensation as per section 1317H and pecuniary penalty order as per section 1317G. As per the section 206C (2) based on the application of ASIC, the court might disqualify an individual from undertaking the responsibility of managing a company if the individual contravenes their responsibilities stated under Corporations Act 2001 or if the court is convinced about the justification of disqualification¹⁵. On the other hand, the order of disqualification of the position of manager or director can be issues based on the section 206E if the individual has been in managerial position at least twice in the organisation and has yet breached his responsibilities¹⁶. This law is also applicable if the individual has contravened the law at least twice. Findings from this case provide the understanding that Mr Adler, despite having a clear understanding of his actions has repeatedly breached his duties as a director¹⁷. Therefore, despite

¹³ *Corporations Act 2001* (Cth) s180

¹⁴ *Corporations Act 2001* (Cth) s181

¹⁵ *Corporations Act 2001* (Cth) s206C

¹⁶ *Corporations Act 2001* (Cth) s206E

¹⁷ Conaglen, M., (2013). Interaction between Statutory and General Law Duties Concerning Company Director Conflicts, *Company and Securities Law Journal*, 31(7), pp. 417

Case review: ASIC v Adler [2002]

the ratification of three of the member of HIH board the court highlighting the difference between prior approval and ratification and marked the period of disqualification as 20 years.

As per section, 1317H of the Corporations Act a court might order an individual to pay compensation to a business corporation if the action of the individual causes damage because of the contravention¹⁸. Based on this piece of legislation Mr Adler, along with the three other defendants is identified by the court liable to avail compensation to the company. As stated in section 1317G of the Corporations Act 2001, the court might instruct an individual to pay a pecuniary penalty up to the amount of \$200,000 if the court identifies a contravention being made by the individual¹⁹. In the respect, the ASC versus Donovan case is to be referred in which the court stated that, no pecuniary penalty should be more than the amount needed to comply with the standards of the commercial behaviour for the management of corporation through deterrents²⁰. Therefore, the court ordered pecuniary penalty worth \$450,000 for Mr Adler and a similar amount for the Adler Corporation²¹.

Lessons concerning management of Australian companies acquired from this case

Through the evaluation of the ASIC versus Adler case, it is evident that the director duties within the business organisations are the subject to the direct scrutiny of the corporate law and the business organisations need to undertake suitable compliance procedure for avoiding such misconduct in future. This also provides the understanding that directors of a business organisation are expected to exercise their power and release of their responsibilities on reasonable grounds and in good faith to ensure continued growth and sustenance of the company in the market. Yet, Mr Adler's attempt of stabilising the value of HIH's share in the market through making the false impression of supporting the organisation through share purchase served as a false message to the market. Therefore, the judgement of this case also avails the understanding that while ensuring the growth or sustainability of the business organisation the director must not provide the false impression to the shareholders and the market in general

¹⁸ *Corporations Act 2001* (Cth) s1317H

¹⁹ *Corporations Act 2001* (Cth) s1317G

²⁰ Sise, P., (2016). An Alternative Approach to the Treatment of Penalties and Fines in Bankruptcy, *QUT L. Rev.*, 16, p.84

²¹ *ASIC v Adler* [2002] ASIC v Adler [2002] NSWSC 171 ACLC 576 2753/01 2753/01 (Supreme Court of New South Wales Equity Division), p.63

Case review: ASIC v Adler [2002]

about the position of the company. Finally, the case also serves as guidance for the business operators in Australia by highlighting the fact that in all circumstances a director of a business organisation is expected not to use their power inappropriately to generate value for themselves or for other individuals. It also highlights that in such instances the accused person is subject to severe punishment and compensation.

Relative observations

While evaluating the consequences of Adler's actions and the ratifications of three other directors of HIH that the first defendant availed the court highlighted the difference between prior approval and ratification. The court mentioned explained the reason behind such evaluation stating that there lies severe doubt about the potentiality of the ratification at the instance of the director's under consideration were made aware of all the unlisted investments and loans that were made. Moreover, as per section 208 of the Corporations Act 2001, the approval of the directors are to be acquired for availing any financial profit to one member of the board which is crucial in this situation as it nullifies the validity of the ratifications²².

Conclusion

Completion of this essay has generated a considerable understanding of the Corporation Law of Australia and directorial duties associated with it. Mr Adler's actions throughout the case highlight the contravention with the directorial duties and avail the understanding that actions of the second, third and fourth defendant are partially stimulated by Adler as well, which makes him accessorially liable for their contraventions. Due to such actions, Mr Adler suffered disqualification from the responsibility of the director of any business organisation for twenty years along with compensation of \$450,000 for own-self and similar compensation for the Adler Corporation highlighting the severity of the actions in the view of the court.

²² *Corporations Act 2001* (Cth) s208

Case review: ASIC v Adler [2002]

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Corporations Act 2001 (Cth) s181

Corporations Act 2001 (Cth) s182

Corporations Act 2001 (Cth) s183

Corporations Act 2001 (Cth) s206A

Corporations Act 2001 (Cth) s206C

Corporations Act 2001 (Cth) s206E

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