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info.regulatory@saiglobal.com

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Editor: Professor Ian Ramsay, Director, Centre for Corporate Law and Securities Regulation

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1. Recent Corporate Law and Corporate Governance Developments

1.1 New corporate governance principles proposed by CEOs and institutional investors

21 July 2016 - a group of executives of major US companies (including General Motors, GE and Verizon) and institutional investors (including Vanguard and State Street Global Advisers) has published a 9 page set of corporate governance principles. The Principles deal with the board of directors - composition and internal governance; board of directors' responsibilities; shareholder rights; public reporting; board leadership; management succession planning, management remuneration; and asset managers' role in corporate governance.

The group provides the following summary of some of the Principles:

- truly independent corporate boards are vital to effective governance so no board should be beholden to the CEO or management. Every board should meet regularly without the CEO present, and every board should have active and direct engagement with executives below the CEO level;
- diverse boards make better decisions, so every board should have members with complementary and diverse skills, backgrounds and experiences. It is also important to balance wisdom and judgment that accompany experience and tenure with the need for fresh thinking and perspectives of new board members;
- every board needs a strong leader who is independent of management. The board's independent directors usually are in the best position to evaluate whether the roles of chairperson and CEO should be separate or combined; and if the board decides on a combined role, it is essential that the board have a strong lead independent director with clearly defined authorities and responsibilities;
- the US financial markets have become too obsessed with quarterly earnings forecasts. Companies should not feel obligated to provide earnings guidance - and should do so only if they believe that providing such guidance is beneficial to shareholders;
- a common accounting standard is critical for corporate transparency, so while companies may use non-Generally Accepted Accounting Principles (GAAP) to explain and clarify their results, they never should do so in such a way as to obscure GAAP-reported results; and in particular, since stock- or options-based compensation is plainly a cost of doing business, it always should be reflected in non-GAAP measurements of earnings; and

- effective governance requires constructive engagement between a company and its shareholders, so the company's institutional investors making decisions on proxy issues important to long-term value creation should have access to the company, its management and, in some circumstances, the board; similarly, a company, its management and board should have access to institutional investors' ultimate decision makers on those issues.

1.2 Report on corporate culture and the role of boards

20 July 2016 - the UK Financial Reporting Council (FRC) has published a report (Corporate Culture and the Role of Boards) on the results of its study exploring the relationship between corporate culture and long-term business success in the UK.

Key findings of the study are:

- **Recognise the value of culture:** A healthy corporate culture is a valuable asset, a source of competitive advantage and vital to the creation and protection of long-term value. It is the board's role to determine the purpose of the company and ensure that the company's values, strategy and business model are aligned to it. Directors should not wait for a crisis before they focus on company culture;
- **Demonstrate leadership:** Leaders, in particular the chief executive, must embody the desired culture, embedding this at all levels and in every aspect of the business. Boards have a responsibility to act where leaders do not deliver;
- **Be open and accountable:** Openness and accountability matter at every level. Good governance means a focus on how this takes place throughout the company and those who act on its behalf. It should be demonstrated in the way the company conducts business and engages with and reports to stakeholders. This involves respecting a wide range of stakeholder interests;
- **Embed and integrate:** The values of the company need to inform the behaviours which are expected of all employees and suppliers. Human resources, internal audit, ethics, compliance, and risk functions should be empowered and resourced to embed values and assess culture effectively. Their voice in the boardroom should be strengthened;
- **Assess, measure and engage:** Indicators and measures used should be aligned to desired outcomes and material to the business. The board has a responsibility to understand behaviour throughout the company and to challenge where they find misalignment with values or need better information. Boards should devote sufficient resource to evaluating culture and consider how they report on it;
- **Align values and incentives:** The performance management and reward system should support and encourage behaviours consistent with the

company's purpose, values, strategy and business model. The board is responsible for explaining this alignment clearly to shareholders, employees and other stakeholders; and
- **Exercise stewardship:** Effective stewardship should include engagement about culture and encourage better reporting. Investors should challenge themselves about the behaviours they are encouraging in companies and to reflect on their own culture.

1.3 European Commission: new rules to support investment in venture capital and social enterprises

14 July 2016 - The European Commission has proposed amendments to the European Venture Capital Funds (EuVECA) and the European Social Entrepreneurship Funds (EuSEF) regulations, marking another step towards the creation of the Capital Markets Union.

The proposal aims to boost investment into venture capital and social projects and make it easier for investors to invest in small and medium-sized innovative companies. In particular, the Commission is proposing to open up the EuVECA and EuSEF fund labels to fund managers of all sizes, and to expand the range of companies in which investments can be made. The Commission also aims to make the cross border marketing of EuVECA and EuSEF funds cheaper and easier by explicitly prohibiting fees levied by Member States and simplifying registration processes.

The EuVECA and EuSEF regulations set up two new types of collective investment funds to make it easier and more attractive for investors to invest in unlisted SMEs. Both Regulations were adopted on 17 April 2013 and came into force on 22 July 2013.

The EuVECA and EuSEF label allows fund managers to market these funds across the EU to professional investors and to non-professional investors able to commit a minimum of €100,000.

Given the importance of making progress towards the Capital Markets Union, the Commission decided to bring forward the general review originally planned for July 2017. The European Commission launched a consultation on 30 September 2015 to ask whether targeted changes to the Regulations could boost the take-up of these investment funds. The review identified a number of factors holding back the development of these funds.

Building on the outcome of this consultation, the Commission proposes to:

- extend the range of managers eligible to market and manage EuVECA and EuSEF funds to include larger fund managers, i.e. those with assets under

management of more than €500 million. Large managers can provide economies of scale and trusted brands, offering benefits for investors who in turn can invest more for the ultimate benefit of venture capital and social enterprises;
- expand EuVECA eligible assets, to allow investment in small mid-caps, and SMEs listed on SME growth markets. This is expected to allow more companies to benefit from EuVECA investments and make investments more attractive through greater diversification of risk; and
- decrease the costs explicitly prohibiting fees imposed by competent authorities of host Member States, simplifying registration processes and determining the minimum capital to become manager.

As part of the wider CMU package to stimulate venture capital investments in the EU, a pan-European venture capital fund of funds will combine EU financial sources with greater volumes of private capital. This pan-European fund of funds should help to overcome market fragmentation and attract private investors to the EU venture capital asset class**.**

1.4 Redefining accountants' ethical role when laws and regulations broken

14 July 2016 - The International Ethics Standards Board for Accountants (IESBA) has released a new standard, Responding to Non-Compliance with Laws and Regulations. The standard sets out a first-of-its-kind framework to guide professional accountants in what actions to take in the public interest when they become aware of a potential illegal act, known as non-compliance with laws and regulations, committed by a client or employer.

The standard applies to all categories of professional accountants, including auditors, other professional accountants in public practice, and professional accountants in organisations, including those in businesses, government, education, and the not-for-profit sector. It addresses breaches of laws and regulations that deal with matters such as fraud, corruption and bribery, money laundering, tax payments, financial products and services, environmental protection, and public health and safety.

Among other matters, the new standard provides a clear pathway for auditors and other professional accountants to disclose potential non-compliance situations to appropriate public authorities in certain situations without being constrained by the ethical duty of confidentiality. It also places renewed emphasis on the role of senior-level accountants in business in promoting a culture of compliance with laws and regulations and prevention of non-compliance within their organisations.

The standard will be effective July 15, 2017, with early adoption permitted.

1.5 UK reforms proposed to protect consumers when retailers fail

There has been debate in a number of countries regarding whether additional protections for consumers are needed when retailers fail and consumers have paid money for products they have not received. Most recently in Australia, there was debate about this issue when the retailer Dick Smith failed. On 14 July 2016, the UK Law Commission published a report recommending that consumers paying a cash deposit of £250 or more within six months of a retailer failing should be moved up the priority list when it comes to getting their money back.

As well as protections for larger cash deposits, the Commission is also recommending that banks should do more to tell their customers about existing protections for card transactions. In preparing its report, Consumer Prepayments on Retailer Insolvency, the Commission has conducted a full review of the law relating to consumer prepayments. It concludes that providing mandatory protection for small losses would be costly and disproportionate, but calls for statutory protections in sectors where the risk to prepaying customers is particularly high.

1.6 Confidence grows in audit, but more needs to be done: FRC report

14 July 2016 - Confidence in audit has grown, but more needs to be done in terms of market competition and improving good practice in the profession, according to a report issued by the UK Financial Reporting Council (FRC).

A survey commissioned by the FRC indicates stakeholders have a clearer understanding of what audit is and a higher level of confidence in it. But recent corporate failures and the resulting increased public scrutiny of auditors have undermined some of this progress.

The FRC's report on the current state of audit identified these key influences on confidence:

- audit firms are seen as more independent and competing for audit engagements on quality grounds, but concern remains that the FTSE 350 audit market is concentrated across the Big Four firms, as the smaller firms are thought to struggle to match on skill level, resource and ability to bear the cost of tendering processes;
- EU regulatory changes have also bolstered confidence, with the introduction of mandatory rotation and the tightening of rules around non-audit service provision. However, some fear the increased public and

regulatory scrutiny could deter future talent from joining the profession, thus impacting long-term quality;

- the FRC's audit monitoring results and those of the professional bodies show audit quality in the UK is improving. In 2015/16 the FRC assessed 77% of FTSE 350 audits it reviewed as requiring no more than limited improvements. The FRC considers that at least 90% of FTSE 350 audits should fall into that category by the end of its 2016/19 strategy; and
- the large firms are beginning to improve the effectiveness and efficiency of audit through the transformative use of technology**,** which should prompt further competition on quality. This raises further concerns about smaller firms' ability to compete, what the role is for the auditor and how regulators and standard setters will be able to keep up.

View the FRC report and the commissioned survey on the FRC website

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1.7 SEC adopts additional rules related to security-based swap transaction reporting

13 July 2016 - The US Securities and Exchange Commission (SEC) has announced that it has adopted amendments and guidance related to rules regarding the regulatory reporting and public dissemination of security-based swap transactions, known as Regulation SBSR. The new rules and guidance are designed to increase transparency in the security-based swap market.

The rules and guidance implement mandates under Title VII of the *Dodd-Frank Wall Street Reform and Consumer Protection Act*.

The final rules and guidance addressing security-based swap data reporting and public dissemination, known as Regulation SBSR, would:

- require a national securities exchange or security-based swap execution facility to report a security-based swap executed on the platform that will be submitted to clearing;
- require a registered clearing agency to report any security-based swap to which it is a direct counterparty, as well as whether the clearing agency accepts a transaction for clearing;
- prohibit a registered SDR from imposing fees or usage restrictions on the security-based swap transaction data that it is required by Regulation SBSR to publicly disseminate;
- require any security-based swap transaction connected with a non-US person's security-based swap dealing activity that is arranged, negotiated, or executed by personnel of such non-US person located in a US branch or office-or by personnel of its agent located in a US branch or office-to be reported and publicly disseminated;

- provide guidance regarding the application of Regulation SBSR to security-based swaps resulting from prime brokerage arrangements and from the allocation of cleared security-based swaps; and
- establish a compliance schedule for the portions of Regulation SBSR for which the Commission has not previously specified compliance dates. Under the new compliance schedule, transaction reporting will not begin until after security-based swap dealers and major security-based swap participants have registered with the Commission.

Regulation SBSR-Reporting and Dissemination of Security-Based Swap Information

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1.8 Corporate law reforms proposed by new British PM Theresa May

On 11 July 2016 new British Prime Minister Theresa Mary gave a speech in which she proposed new corporate law reforms that include employee representation on boards of directors and making the shareholder advisory vote on remuneration binding. Following are extracts from her speech.

".I want to see changes in the way that big business is governed. The people who run big businesses are supposed to be accountable to outsiders, to non-executive directors, who are supposed to ask the difficult questions, think about the long-term and defend the interests of shareholders. In practice, they are drawn from the same, narrow social and professional circles as the executive team and - as we have seen time and time again - the scrutiny they provide is just not good enough. So if I'm Prime Minister, we're going to change that system - and we're going to have not just consumers represented on company boards, but employees as well".

"There are other ways, too, in which we need to put people back in control. As the Government reforms public services, we should encourage public sector workers to set up mutuals. As we take infrastructure decisions - like with new housing, roads, or exploration for oil and gas - the benefits should be shared not just with local authorities but with local people themselves."

"The fourth way in which I want to make our economy work for everyone is by getting tough on irresponsible behaviour in big business. Because yes, we're the Conservative Party, and yes we're the party of enterprise, but that does not mean we should be prepared to accept that anything goes".

"The FTSE, for example, is trading at about the same level as it was eighteen years ago and it is nearly ten per cent below its high peak. Yet in the same time period executive pay has more than trebled and there is an irrational, unhealthy and growing gap between what these companies pay their workers and what they pay their bosses".

"So as part of the changes I want to make to corporate governance, I want to make shareholder votes on corporate pay not just advisory but binding. I want to see more transparency, including the full disclosure of bonus targets and the publication of "pay multiple" data: that is, the ratio between the CEO's pay and the average company worker's pay. And I want to simplify the way bonuses are paid so that the bosses' incentives are better aligned with the long-term interests of the company and its shareholders".

"I also want us to be prepared to use - and reform - competition law so that markets work better for people. If there is evidence that the big utility firms and the retail banks are abusing their roles in highly-consolidated markets, we shouldn't just complain about it, we shouldn't say it's too difficult, we should do something about it".

"And tax. We need to talk about tax. Because we're Conservatives, and of course we believe in a low-tax economy, in which British businesses are more competitive and families get to keep more of what they earn - but we also understand that tax is the price we pay for living in a civilised society. No individual and no business, however rich, has succeeded all on their own. Their goods are transported by road, their workers are educated in schools, their customers are part of sophisticated networks taking in the private sector, the public sector and charities. It doesn't matter to me whether you're Amazon, Google or Starbucks, you have a duty to put something back, you have a debt to your fellow citizens, you have a responsibility to pay your taxes. So as Prime Minister, I will crack down on individual and corporate tax avoidance and evasion".

1.9 Review of UK crowdfunding rules

8 July 2016 - The UK Financial Conduct Authority (FCA) is seeking input on which areas should be considered as part of its upcoming review of the rules surrounding both investment-based and loan-based crowdfunding.

In 2015 an estimated £2.7billion was invested on regulated crowdfunding platforms, up from £500 million in 2013, with more than 100 platforms either operating in the market or seeking authorisation. The FCA introduced rules for the regulation of crowdfunding platforms in March 2014 and committed at the time to a full review of their impact.

In its call for input the FCA is seeking views on a number of issues related to loan-based crowdfunding including:

- considering whether financial promotions, due diligence and prudential standards are still appropriate for the way the market has developed;
- whether to mandate in greater detail the disclosure firms are expected to give consumers and the time that the disclosures must be provided; and

- whether platforms should be required to assess investor knowledge or experience of the risks involved in this type of investment.

The FCA is also seeking views on its regulation of investment -based crowdfunding including:

- how conflicts of interest are managed on these types of platform;
- whether the due diligence rules for platforms need to be strengthened; and
- whether to mandate the disclosure of risk warnings in relation to non-readily realisable securities (such as unlisted equities) held within Innovative Finance ISAs.

1.10 Scope for greater EU harmonisation in prospectuses approval test

30 June 2016 - The European Securities and Markets Authority (ESMA) has published a peer review on the efficiency and effectiveness of European Union (EU) national securities markets regulators' approval of prospectuses.

Overall, ESMA found that, while national regulators were in general sufficiently resourced and approved prospectuses within legal deadlines, there were differences in national practices which would benefit from greater convergence.

ESMA's review covered a two-year period from January 2013 to December 2014. The main findings were:

- Prospectuses are often complex and may therefore be difficult for investors to understand, according to external stakeholders interviewed by ESMA. Main concerns include their length, the format of the summary section, and the amount and manner in which information is incorporated by reference;
- National regulators have different interpretations of certain disclosure requirements which would benefit from further harmonisation, as would the way in which national regulators look at risk factors associated with issuers and their securities;
- Approval times vary substantially among national regulators, however, the driving factors largely fall outside national regulators' responsibilities and include:
    - quality of the first draft they receive;
    - issuers' response times to queries;
    - the quality of those responses; and
    - the complexity of issuers' circumstances.

1.11 Sustainability reporting of ASX companies: study

30 June 2016 - Quality sustainability reporting is no longer the sole province of the mining and banking sectors, with nearly all Australian industry sectors having at least one "leading" reporter which is setting the standard for that sector.

Research by the Australian Council of Superannuation Investors shows that 71 cents in every dollar invested in the ASX200 is now invested in companies shown as reporting on ESG to a "leading" standard. The finding emerged from ACSI's annual review of corporate sustainability disclosure, now in its ninth year, which assesses the level of public reporting by Australia's largest listed companies.

The 2016 review found that 90% of ASX200 companies provided some level of reporting on sustainability factors in their 2015 public disclosures, with the most improved sectors being utilities, gas, and energy distribution companies.

For the first time last financial year, under ASX rule changes supported by ACSI, sustainability disclosures were compulsory for listed companies. Reflecting this, "No Reporting" companies in the ASX200 fell from 26 in 2015 to just nine in 2016. Fifty seven companies - approximately 30% of the total ASX200 by number - were assessed as either "No Reporting" or "Basic", which falls short of what ACSI considers to be an acceptable reporting standard. Companies in both of these categories will remain a focus of ACSI's engagement program in the coming year.

1.12 Guidance on cyber resilience for financial market infrastructures

29 June 2016 - The Committee on Payments and Market Infrastructures (CPMI) and the Board of the International Organization of Securities Commissions (IOSCO) have jointly released the final report Guidance on cyber resilience for financial market infrastructures (the Cyber Guidance). This Cyber Guidance is the first internationally agreed guidance on cyber security for the financial industry. It has been developed against the backdrop of a rising number of cyber-attacks against the financial sector and in a context where attacks are becoming increasingly sophisticated.

The aim of the Cyber Guidance is to add momentum to the industry's ongoing efforts to enhance financial market infrastructures' (FMIs) ability to pre-empt cyber-attacks, respond rapidly and effectively to them, and achieve faster and safer target recovery objectives if the attacks succeed. Another goal is to ensure that these efforts to build resilience are similar from one country to another. Thus, the Cyber Guidance provides authorities with a set of internationally agreed guidelines to support consistent and effective oversight and supervision of FMIs in the area of cyber risk.

1.13 APRA proposes revisions to the role of the appointed actuary and actuarial advice for insurers

29 June 2016 - The Australian Prudential Regulation Authority (APRA) has released for consultation a discussion paper with proposals to streamline and sharpen the role of the Appointed Actuary within general and life insurers.

The Appointed Actuary plays an important role by providing independent, expert advice to boards and senior management on the key financial risks facing an insurer.

In the discussion paper, APRA has identified a set of proposals to improve the functioning of the Appointed Actuary role and ensure that it remains fit-for-purpose. The proposals are intended to improve outcomes for the industry, the actuarial profession and APRA, by strengthening the ability of the Appointed Actuary to act as a key strategic advisor to insurers and their boards.

The main proposals in the discussion paper cover the following areas:

- introducing a purpose statement for Appointed Actuaries;
- implementing a clear actuarial advice framework;
- managing potential conflicts of interest;
- improving reporting requirements; and
- simplifying prudential standards.

1.14 Implementation monitoring of payments and market infrastructure: assessment report

28 June 2016 - The Committee on Payments and Market Infrastructures (CPMI) and the International Organization of Securities Commissions (IOSCO) have jointly published the Third Update to the Level 1 assessments of implementation monitoring of the Principles for Financial Market Infrastructures (PFMI).

Level 1 assessments are based on self-assessments by individual jurisdictions on how they have adopted, within their regulatory and oversight frameworks, the PFMI's 24 Principles for FMIs and four of the five Responsibilities for authorities.

The initial Level 1 assessment was conducted in mid-2013, and a report was published in August 2013. The current report is the third update to the Level 1

assessments, and reflects the status of jurisdictions' legal, regulatory or policy frameworks as at 8 January 2016.

The results show that further progress has been made among those participating jurisdictions that had not completed their implementation measures at the time of the previous update in 2015. In particular, 19 of the 28 jurisdictions have now completed their implementation measures for all FMI types (15 jurisdictions in the previous update). The next update of the Level 1 assessment will be conducted in 2017.

Alongside their updates to the Level 1 assessment, the CPMI and IOSCO continue to monitor jurisdictions' progress at Levels 2 and 3. These assessments consider, respectively, the completeness of jurisdictions' implementation measures and their consistency with the PFMI, and consistency in the outcomes of such frameworks.

1.15 SEC proposes rule requiring investment advisers to adopt business continuity and transition plans

28 June 2016 - The US Securities and Exchange Commission (SEC) has proposed a new rule that would require registered investment advisers to adopt and implement written business continuity and transition plans. The proposed rule is designed to ensure that investment advisers have plans in place to address operational and other risks related to a significant disruption in the adviser's operations in order to minimise client and investor harm.

Business continuity and transition plans would assist advisers in preserving the continuity of advisory services in the event of business disruptions - whether temporary or permanent - such as a natural disaster, cyber-attack, technology failure, departure of key personnel, and similar events.

The proposed rule would require an adviser's plan to be based upon the particular risks associated with the adviser's operations and include policies and procedures addressing the following specified components: maintenance of systems and protection of data; pre-arranged alternative physical locations; communication plans; review of third-party service providers; and plan of transition in the event the adviser is winding down or is unable to continue providing advisory services. The plans would be required to address these elements that are critical to minimising and preparing for material service disruptions, but would permit advisers to tailor the detail of their plans based upon the complexity of their business operations and the risks attendant to their particular business models and activities.

The proposed rule and rule amendments also would require advisers to review the adequacy and effectiveness of their plans at least annually and to retain certain related records.

1.16 Assessment of UK remuneration reporting rules

27 June 2016 - A new study from Cambridge Judge Business School and King's College London finds that the first year of new UK remuneration disclosure rules did not curb CEO pay or enhance the link between CEO pay and firm performance at FTSE 100 companies, but led instead to "opportunistic reporting for the sake of reputation management".

The study found that in submitting comparative information about pay of CEOs and employees, many big UK companies "self-select" by choosing only certain geographies or types of workers - an invitation to "cherry-picking" which "seriously compromises the reliability" of the comparative disclosure rules.

The study looked at the first-year results of UK disclosure rules that took effect 1 October 2013, which applied to quoted UK companies in financial years ending on or after 30 September 2013.

The 2013 regulations entitled, *Large and Medium-sized Companies and Groups* were intended to "restore a stronger, clearer link between pay and performance" and ensure "greater transparency" on pay, according to a Department for Business, Innovation and Skills (BIS) discussion document. There was "compelling evidence of a disconnect between pay and performance in large UK listed companies and the call for action has been loud and clear," then-business secretary Vince Cable said in 2012.

The study looked at 91 UK companies (excluding those FTSE 100 firms not incorporated in the UK and thus exempt from the disclosure regulations) over three fiscal years ending in 2014.

On the comparison of CEO pay and other employee pay, the study found that firms had a "high degree of flexibility and variation" in choosing their comparator groups - with only 24 of the 91 firms including employees from all geographic regions and all levels. Some firms chose only an "arbitrary percentage" of employees (such as 40%), or only senior management, or only employees in certain geographic areas such as London.

The study also found that firms with prior advisory shareholder votes of dissent on executive pay actually had "less voluntary disclosure, greater pay and higher pay ratios" between CEOs and other employees. This, the researchers said, supports other new rules introduced in 2013 that requires a binding vote on remuneration

policy at least every three years, or at the next annual general meeting if the company's remuneration report fails to achieve a majority advisory vote.

1.17 SEC adopts rules for resource extraction issuers under Dodd-Frank Act

27 June 2016 - The US SEC has announced it adopted rules to require resource extraction issuers to disclose payments made to governments for the commercial development of oil, natural gas or minerals. The rules, mandated by the *Dodd-Frank Wall Street Reform and Consumer Protection Act*, are intended to further the statutory objective to advance US foreign policy interests by promoting greater transparency about payments related to resource extraction.

The final rules require an issuer to disclose payments made to the US federal government or a foreign government if the issuer engages in the commercial development of oil, natural gas, or minerals and is required to file annual reports with the Commission under the *Securities Exchange Act*. The issuer must also disclose payments made by a subsidiary or entity controlled by the issuer.

Under the final rules, resource extraction issuers must disclose payments that are: made to further the commercial development of oil, natural gas, or minerals; *not de minimis*; and within the types of payments specified in the rules. The final rules define commercial development of oil, natural gas, or minerals as exploration, extraction, processing, and export, or the acquisition of a license for any such activity.

The rules define *not de minimis* as any payment, whether a single payment or a series of related payments, which equals or exceeds US$100,000 during the same fiscal year. Payments that must be disclosed are: taxes; royalties; fees (including license fees); production entitlements; bonuses; dividends; payments for infrastructure improvements; and, if required by law or contract, community and social responsibility payments. The disclosure must be made at the project level, similar to the approach adopted in the EU and Canada.

1.18 FSB publishes recommendations to address structural vulnerabilities from asset management activities

22 June 2016 - The Financial Stability Board (FSB) has published for public consultation Proposed Policy Recommendations to Address Structural Vulnerabilities from Asset Management Activities.

The document sets out 14 proposed policy recommendations to address the following structural vulnerabilities from asset management activities that could potentially present financial stability risks:

- liquidity mismatch between fund investments and redemption terms and conditions for fund units;
- leverage within investment funds;
- operational risk and challenges in transferring investment mandates in stressed conditions; and
- securities lending activities of asset managers and funds.

The FSB's work to understand and address potential financial stability risks from structural vulnerabilities associated with asset management activities was launched in March 2015, in part due to recent growth in asset management activities. Asset management activities have increased significantly over the past decade, including through open-ended funds that offer daily redemptions to their investors. Such growth has been accompanied by increased investment in particular asset classes, which encompass some less actively traded markets.

Among the above four structural vulnerabilities, issues associated with liquidity mismatch and leverage are considered key vulnerabilities. The recommendations for liquidity mismatch focus on open-ended funds (public and private, including exchange-traded funds but excluding money market funds). Those for leverage are meant to apply to all types of funds that may use leverage (that may arise through borrowings or through the use of derivatives). Meanwhile, recommendations for operational risk focus on asset managers that are large, complex, and/or provide critical services, and those for securities lending activities focus on asset managers' agent lender activities (i.e. lending of securities of which an entity is not the beneficial owner), in particular their provision of indemnities to clients.

1.19 SEC proposes rules to modernise property disclosures for mining registrants

16 June 2016 - The US SEC has announced that it has proposed rules to modernise the disclosure requirements for mining properties by aligning them with current industry and global regulatory practices and standards. The proposed revisions would update disclosure requirements for mining registrants in Item 102 of Regulation S-K under the *Securities Act of 1933* and the *Securities Exchange Act of 1934* and related guidance in *Industry Guide 7*.

The Commission's proposed rules would:

- provide one standard requiring registrants to disclose mining operations that are material to the company's business or financial condition;

- require a registrant to disclose mineral resources and material exploration results in addition to its mineral reserves;
- permit disclosure of mineral reserves to be based on a preliminary feasibility study or a final feasibility study;
- provide updated definitions of mineral reserves and mineral resources;
- require, in tabular format, summary disclosure for a registrant's mining operations as a whole as well as more detailed disclosure for material individual properties;
- require that every disclosure of mineral resources, mineral reserves and material exploration results reported in a registrant's filed registration statements and reports be based on, and accurately reflect information and supporting documentation prepared by a "qualified person"; and
- require a registrant to obtain a technical report summary from the qualified person, which identifies and summarises for each material property the information reviewed and conclusions reached by the qualified person about the registrant's exploration results, mineral resources or mineral reserves.

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2. Recent ASIC Developments

2.1 Consultation on proposed guidance on risk management

21 July 2016 - The Australian Securities and Investments Commission (ASIC) has released a consultation paper and proposed regulatory guidance on risk management practices for responsible entities in the managed funds sector.

Consultation Paper 263: Risk Management Systems of Responsible Entities: Further Proposals (CP 263) and the proposed guidance builds on the proposals in Consultation Paper 204: Risk Management Systems of Responsible Entities (CP 204).

The proposed guidance does not impose new obligations on responsible entities but gives more detailed guidance on how they may comply with their current obligations under s. 912(1)(h) of the Corporations Act 2001 (Cth) to maintain adequate risk management systems.

It outlines ASIC's expectations for responsible entities to have:

- overarching risk management systems in place;
- processes for identifying and assessing risks; and
- processes for managing risks.

2.2 Consultation on sunsetting class order about nominee and custody services and proposed changes to platforms policy

21 July 2016 - ASIC has released a Consultation Paper (CP 264) proposing to remake its class order on nominee and custody services, which is currently due to expire (sunset) on 1 April 2017, and proposed changes to platforms policy.

ASIC proposes to remake the class order with changes. In ASIC's view, generally the class order is operating effectively and efficiently and an amended version of the class order would continue to form a necessary and useful part of the legislative framework. The fundamental policy principles that underpin the class order have not changed.

The new instrument would continue the relief currently given by Class Order [CO 02/295] Nominee and custody services with changes, so that the ongoing effect will be preserved without any disruption to the entities that rely on it. ASIC is proposing:

- to remove unnecessary Chapter 5C relief as a nominee and custody service is generally not considered to be a registered managed investment scheme;
- to make it clear that relief applies to AFS licensees; and
- to align the relief for nominee and custody services with the equivalent requirements for platforms.

ASIC also seeks feedback on its proposed changes to the relief currently given in Class Order [CO 13/763] Investor directed portfolio services and Class Order [CO 13/762] Investor directed portfolio services provided through a registered managed investment scheme. ASIC is proposing:

- for issues or sales after 30 June 2017- to require that clients of platform and nominee and custody services have access to a product issuer's internal and external dispute resolution system when they have concerns about investments made through the platform or nominee and custody service, as if they were a direct investor in the product; and
- to update the definition of an 'IDPS' and an 'IDPS-like scheme' to clarify what is covered by these definitions.

2.3 Report on review of due diligence practices in IPOs

14 July 2016 - An ASIC review of issuer due diligence in initial public offerings (IPO), has found a close correlation between defective disclosure in a prospectus and poor due diligence.

REP 484 Due diligence practices in initial public offerings (REP 484) includes this and other findings and provides ASIC's recommendations for good practice due diligence for issuers and directors.

Between November 2014 and January 2016, ASIC conducted systematic reviews of the due diligence practices of 12 IPO issuers, ranging from small, mid-sized and larger offers and a sample of offers from emerging market issuers. While ASIC often conducts reviews of due diligence in relation to particular disclosure issues in a prospectus, the reviews outlined in REP 484 focus on the practices and processes adopted by issuers.

Key observations arising from the review include:

- the adoption of poor due diligence practices often produced prospectuses with defective disclosure;
- the issuers and their directors should conduct an effective due diligence process to mitigate the risk of any future liability from a poor-quality prospectus;
- it is important for directors of issuers and their advisers to be actively engaged in the due diligence process;
- additional procedures may be required to overcome the additional challenges of foreign laws, language barriers and supervision for emerging market issuers; and
- a low-cost due diligence process may often lead to delays, further work and ultimately be more costly to an issuer.

Common concerns identified during ASIC's reviews included variation in the quality of due diligence processes, a form over substance approach and a lack of involvement by the directors of the issuer. In general, these concerns were identified in small to mid-sized issuers.

2.4 Consultation on remaking and repealing class orders on markets and securities

13 July 2016 - ASIC has released a Consultation Paper proposing to maintain markets and securities relief that ASIC has previously provided from certain obligations under the Corporations Act 2001 (Cth).

The consultation paper also sets out ASIC's proposal to withdraw some relief. This consultation paper is part of ASIC's response to the sunsetting of legislative instruments.

The instruments which ASIC proposes to remake are:

- *Class Order [CO 01/1519] Disclosure of directors' interests*;

- *Class Order [CO 02/313] Part 7.11 - Transfers of securities under Division 3*;
- *Class Order [CO 02/608] Warrants: relief from PDS requirements for secondary sales*;
- *Corporations (Low Volume Financial Markets) Exemption Notice 2003*;
- *Class Order [CO 03/826] Market related records: Australian financial service licensees dealing on overseas markets*;
- *Class Order [CO 03/911] Licensing relief for self-dealers who provide general product advice about own securities*;
- *Class Order [CO 03/957] ASX managed investment warrants - disclosure and reporting exemptions*;
- *Class Order [CO 06/682] Multiple derivative issuers*; and
- *Class Order [CO 07/183] Transfer of Australian securities traded in New Zealand.*

ASIC has found these instruments are operating effectively and efficiently, and continue to form a necessary and useful part of the legislative framework. ASIC is therefore proposing that these instruments will continue in operation.

However, ASIC is proposing to vary the application of the *Corporations (Low Volume Financial Markets) Exemption Notice 2003* by increasing the transaction threshold of low volume financial markets and amending the transaction period to which the transaction threshold applies.

ASIC also proposes to amend the application of *Class Order [CO 01/1519]* such that it no longer imposes certain conditions on the relief.

ASIC proposes to repeal *Class Order [CO 02/284] CHESS approved foreign securities*, having formed the preliminary view that this relief is no longer required.

Consultation Paper 262: Remaking and Repealing ASIC Class Orders on Markets and Securities (CP 262) outlines the class orders to be remade and the class order to be repealed.

Each instrument has been redrafted using ASIC's current style and format, while preserving the effect of the existing instruments.

2.5 Unlicensed retail OTC derivative providers

6 July 2016 - ASIC has warned of a dramatic increase in the extent of unlicensed conduct by retail OTC derivative providers seeking to expand their market with new customers for their complex and risky products, such as binary options.

Report 482: Compliance Review of the Retail OTC Derivatives Sector (REP 482) highlighted an increase in activity among licensed and other participants, especially binary option providers, operating through online platforms or websites that are offering financial services to retail investors in Australia without an appropriate licence or authorisation.

ASIC has raised its concerns with more than 40 unlicensed providers. The majority are binary option issuers but also contacted were some binary option review websites, binary option trading signal providers, binary option broker affiliate websites, margin FX providers and managed FX service providers.

Of those providers contacted, 21 have agreed to co-operate with ASIC and take remedial steps to ensure they are no longer providing financial services in Australia until they are appropriately licensed or authorised. Remedial actions that have been implemented include:

- removing references to Australia on their website;
- ceasing marketing campaigns directed at Australian investors;
- adding appropriate disclaimers to websites and mobile apps;
- blocking sign-up access to Australian investors;
- educating introducing brokers and affiliates to cease targeting Australian investors;
- closing down existing Australian accounts; and
- informing Australian investors that the entity is not appropriately licensed in Australia.

Some of these entities have indicated an interest in obtaining the appropriate licence to operate in Australia and have been provided with information to assist them with that process. A further nine entities have not directly responded to ASIC but appear to have made some changes to their websites, including removing references to Australia.

2.6 Simplification of registration of company auditors

30 June 2016 - ASIC has released revised Regulatory Guide 180 Auditor Registration (RG 180) which simplifies and improves the registration process for prospective auditors.

The changes to RG 180 concern:

- approval of a new competency standard for satisfying practical experience requirements;
- reducing the paperwork and information required for satisfying an hours-based experience test; and

- updating the professional indemnity insurance requirements for authorised audit companies and new registered company auditors.

The new competency standard simplifies the competency requirements, takes into account new auditing requirements, and adopts a principles-based approach. The new standard was developed jointly by the three largest accounting bodies.

The revised RG 180 streamlines the application forms and supporting documents required to be lodged with ASIC under the hours-based test. This should reduce the time and effort required to make an application.

ASIC has also updated professional indemnity insurance requirements to remain consistent with the limitation of liability schemes for members of two professional accounting bodies that were revised in 2014 under the Professional Standards Council schemes. While the changes come into effect immediately, some applicants may have commenced preparing or lodged an application under the previous guidelines. ASIC will continue to accept applications prepared under the previous guidelines until 30 June 2017.

2.7 Review of 31 December 2015 financial reports

28 June 2016 - ASIC has announced the results from a review of the 31 December 2015 financial reports of 100 listed and other public interest entities.

Following the review, ASIC has made enquiries of 18 entities on 24 matters seeking explanations of accounting treatments.

ASIC's surveillance of the financial reports of public interest entities for reporting periods ended 30 June 2010 to 30 June 2015 has led to material changes to 4% of the financial reports of public interest entities reviewed by ASIC. The main changes over this period related to impairment of assets, revenue recognition and expense deferral.

More information about the findings from ASIC's recent reviews of the financial reports of listed entities and of unlisted entities with larger numbers of users is provided in the attachment to ASIC's media release.

2.8 Remaking of sunsetting class order on financial product advice - exempt documents

24 June 2016 - On 1 June 2016, ASIC made a new legislative instrument to replace its class order on financial product advice - exempt documents that was due to expire (sunset) on 1 April 2017. ASIC has remade the class order following public consultation.

The new legislative instrument is *ASIC Corporations (Financial Product Advice - Exempt Documents) Instrument 2016/356*. The instrument has the same effect as relief that ASIC had granted by *Class Order [CO 03/606]*.

On 16 February 2016, ASIC issued *Consultation Paper 251 Remaking ASIC class order on financial product advice: Exempt documents - [CO 03/606]* (CP 251). CP 251 sought feedback on ASIC's proposals to continue the relief in [CO 03/606] without substantive changes. Comments closed on 18 March 2016 (refer: 16-033MR). ASIC received two submissions to CP 251 in support of the proposals to continue providing the relief.

Related documents:

- ASIC Corporations (Financial Product Advice - Exempt Documents) Instrument 2016/356;
- ASIC Corporations (Repeal) Instrument 2016/452;
- CP 251; and
- Non-confidential submissions to CP 251.

2.9 Report on relief applications

23 June 2016 - ASIC has released its latest report outlining decisions on relief applications. Businesses frequently approach ASIC for assistance to help make the law work better for them. ASIC uses its discretion to vary or set aside certain requirements of the law where there is a net regulatory benefit or where ASIC can facilitate business activity or cut red tape without harming other stakeholders.

ASIC considers this aspect a key element of its function. Between 1 October 2015 and 31 March 2016, ASIC approved 622 relief applications.

Report 483 Overview of Decisions on Relief Applications (October 2015 to March 2016) (REP 483) aims to improve the level of transparency and the quality of publicly available information about decisions ASIC makes when asked to grant relief from provisions of the:

- Corporations Act 2001 (Cth) (Corporations Act); or
- National Consumer Credit Protection Act 2009 (Cth) (National Credit Act).

The report summarises examples of situations where ASIC has exercised, or refused to exercise, its exemption and modification powers under the Corporations Act and the licensing and responsible lending provisions of the National Credit Act. The report also highlights instances where ASIC has considered adopting a no action position regarding specified non-compliance with statutory provisions.

Finally, the report provides examples of decisions that demonstrate how ASIC has applied its policy in practice, which ASIC believes could be of particular interest and use for capital market participants and for participants in the financial services industry. The report includes an appendix detailing the publicly available individual relief instruments referred to in the report.

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3. Recent ASX Developments

3.1 ASX increases investment in Digital Asset Holdings, LLC

On 22 June 2016, ASX announced that it was exercising its right to purchase further equity in the US-based firm Digital Asset Holdings, LLC (Digital Asset). ASX will appoint a representative to the board of Digital Asset as it increases its holding.

Digital Asset has been appointed as ASX's preferred partner to develop a distributed ledger technology solution to address the post-trade needs of the Australian cash equities market.

The announcement is available here.

3.2 Reports: Appendix 4C and Appendix 5B Quarterly Cash Flow Reports

On 27 June 2016, ASX announced that it had finalised its amendments to the *ASX Listing Rules* Appendices 4C and 5B quarterly cash flow reports following its review of the submissions on its consultation paper dated 26 February 2016. Subject to the receipt of the necessary regulatory approvals, ASX anticipates that the new Appendices 4C and 5B will be incorporated into the Listing Rules and come into effect on 1 September 2016. The new forms should be used for all quarterly cash flow reports for quarters ending on or after 30 September 2016.

The reports are available here and the consultation paper dated February 2016 is available here.

3.3 Consultation paper: Changes to clearing participant minimum core capital requirements approach

On 30 June 2016, ASX released a consultation paper which seeks views on ASX's proposed change in approach to determining Participant minimum core capital requirements to more fully reflect the complexity of a Participant's business.

The consultation paper is available here.

3.4 AQUA Products - rule amendments

ASX has made a number of minor amendments to Schedule 10A (AQUA Products and the AQUA Trading Market) of the *ASX Operating Rules and Procedures*, including modifying the requirements for admission of AQUA Products and Issuers.

The notice is available here.

3.5 New record keeping obligation for ETF Special Trades

ASX Operating Rules Procedure 3310 was amended with effect from 1 July 2016. A new record keeping obligation was introduced that requires Trading Participants that execute ETF Special Trades to keep records for a period of at least seven years.

The notice is available here.

3.6 Reports

On 5 July 2016 ASX released:

- ASX Group Monthly Activity Report; and

- ASX Compliance Monthly Activity Report.

These activity reports are for June 2016.

4. Recent Takeovers Panel Developments

4.1 McAleese Limited - Panel declines to conduct proceedings

19 July 2016 - The Takeovers Panel announced it has declined to conduct proceedings on an application dated 15 July 2016 from Havenfresh Pty Ltd in relation to the affairs of McAleese Limited.

The application concerned the proposed recapitalisation of McAleese, announced on 7 June 2016 (see TP16/54).

The Panel considered the circumstances of the proposed senior debt acquisition are not central to the issues which might be of concern to the Panel in the context of the proposed recapitalisation.

The Panel also considered it was premature to conduct proceedings in relation to the circumstances of the proposed issue of options, offer of convertible notes or shareholder approval given the general meeting materials and details of the proposed issue of options and offer of convertible notes have not yet been made public.

The Panel therefore concluded there was no reasonable prospect that it would make a declaration of unacceptable circumstances. Accordingly, the Panel declined to conduct proceedings.

4.2 Sovereign Gold Company Limited - Declaration of unacceptable circumstances and review panel decision

11 July 2016 - The Takeovers Panel announced it has made a declaration of unacceptable circumstances in relation to an application dated 9 June 2016 by Mr Brennan Westworth in relation to the affairs of Sovereign Gold Company Ltd (see TP16/37).

The current directors of Sovereign Gold are Messrs Patrick Glovac, Rocco Tassone and Charles Thomas, who are also the directors of Applabs Technologies

Limited and the founding partners and executive directors of GTT Ventures Pty Ltd.

On 18 May 2015, Sovereign Gold announced a non-renounceable 1 for 1 rights issue at $0.002 per share to raise approximately $790,000. The rights issue was originally not underwritten. On 29 June 2015, Sovereign Gold announced (among other things) that GTT had agreed to partly underwrite the rights issue and that upon completion of the rights issue GTT would appoint two nominees to the Sovereign Gold board and two directors would resign. On 8 July 2015, Sovereign Gold announced that it would place additional shares through GTT. Applabs was allocated Sovereign Gold shares by GTT following the rights issue and placement.

On or about 15 July 2015, Messrs Tassone and Thomas were appointed to the Sovereign Gold board and Messrs Dennis and Rebek resigned. In or around December 2015, GTT distributed shares in Sovereign Gold held by Hudson Resources Ltd to clients including Messrs Glovac, Tassone and Thomas and family members. As part of this, GTT required further resignations from the Sovereign Gold board. On or about 14 December 2015, Mr Glovac was appointed to the Sovereign Gold board and Messrs Dawkins AO and Leu resigned. On 29 February 2016, Simon Bird retired from the board, leaving Messrs Glovac, Tassone and Thomas as the directors of Sovereign Gold.

On 12 April 2016, Mr Westworth was nominated by another shareholder for election to the Sovereign Gold board to be put to shareholders at the company's annual general meeting. At the annual general meeting, Messrs Glovac, Tassone and Thomas were re-elected to the board. Mr Westworth was not elected.

The Panel considers that Messrs Patrick Glovac, Rocco Tassone and Charles Thomas and Applabs (the Associated Parties) are associated:

- under s.12(2)(b) for the purpose of controlling or influencing the composition of Sovereign Gold's board; or
- under s.12(2)(c) in relation to the affairs of Sovereign Gold.

The Panel considers that the Associated Parties' voting power in Sovereign Gold increased beyond the 20% threshold in s. 606 to 21.59% (later diluted to approximately 21.07% following a rights issue) as a result of share acquisitions which occurred without using one of the exceptions in s. 611. The Panel also considers that the combined voting power of the Associated Parties with respect to Sovereign Gold had not been disclosed in accordance with Chapter 6C.

The factors taken into account by the Panel included:

- structural links between the Associated Parties, including common directorships;
- the conduct of the Associated Parties; and
- a common purpose of obtaining control of the board of Sovereign Gold.

The Panel made orders, the effect of which include that:

- 10,000,000 shares acquired by Mounts Bay Investments Pty Ltd and 12,901,234 shares acquired by Syracuse Capital Pty Ltd, in contravention of s. 606, are to be vested in ASIC to sell (using an investment bank or stock broker) and return the proceeds net of costs to the owners;
- the Associated Parties may not rely on the creep exception in item 9 of s. 611 for six months from the date the orders come into effect and cannot take into account the shares to be vested in ASIC in determining whether to rely on the creep exception; and
- each of the Associated Parties must disclose their former and current relevant interests, and their association, in substantial holder notices.

On 11 July 2016, Mr Brennan Westworth sought a review of the initial Panel's decision, in particular in relation to alleged associations not found by the initial Panel. On 20 July 2016, the review Panel announced that it has declined to conduct proceedings and has therefore affirmed the decision of the initial Panel in Sovereign Gold Company Limited. The review Panel, based on a *de novo* review of all the materials, considered that it was unlikely to reach a different conclusion than the initial Panel and declined to conduct proceedings.

4.3 Warrnambool Cheese and Butter Factory Company Holdings Limited 02 - Panel declines to conduct proceedings

1 July 2016 - The Takeovers Panel announced that it has declined to conduct proceedings on an application dated 27 June 2016 from Sandon Capital Investments Limited in relation to the affairs of Warrnambool Cheese and Butter Factory Company Holdings Limited.

The application concerns the entitlement offer announced by Warrnambool on 10 June 2016 (see TP16/43). Among other things, the applicant submitted:

- the entitlement offer is being inappropriately used as a mechanism to enable Saputo Dairy to proceed to compulsory acquisition of the remaining Warrnambool shares; and
- the entitlement offer booklet is deficient as it fails to disclose (a) Saputo Dairy's intentions should it hold 90% or more of Warrnambool after the entitlement offer or (b) sufficient reasons for the size of the entitlement offer, why additional funds are required or the benefits of participating in the offer.

The entitlement offer closed at 5.00pm on 29 June 2016. Following closure of the offer, Warrnambool advised the Panel that there was only approximately 0.3%

shortfall and Saputo Dairy's voting power would be less than 90% as a result of taking up its entitlement.

On the material available, and in view of the outcome of the entitlement offer and the timing of the application, the Panel did not consider that the entitlement offer was likely to be found to give rise to unacceptable circumstances.

The Panel therefore concluded there was no reasonable prospect that it would make a declaration of unacceptable circumstances. Accordingly, the Panel declined to conduct proceedings.

The reasons for the decision of the Panel are available on the Panel's website.

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5. Recent Research Papers

5.1 Corporate governance and the goal of the firm: In defence of shareholder wealth maximisation

The author proposes that misunderstandings about the traditional model of corporate governance, with its emphasis on shareholder wealth maximisation, contribute to negative societal attitudes about corporations. The author discusses the implications of shareholder wealth maximisation for other corporate stakeholders, the dangers of deviating from shareholder wealth maximisation, and the roles that the media and the government play in the governance of corporations.

Corporate governance and the goal of the firm: In defence of shareholder wealth maximisation

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5.2 Board diversity: More than a gender issue?

There has been extensive research conducted on the importance of corporate governance around the world. The research seems to demonstrate that, regardless of whether corporations are based in common law or civil code systems, their longevity and sustainability arise from good corporate governance. However, the evidence does not clearly demonstrate a correlation between a particular organisation's governance structure and practices and its share price. Around the world the question of board diversity is gaining in importance. The beginning of the debate in the 1960s centred on gender. While it is essential to conduct a debate on gender diversity, other aspects of diversity should also be considered: race,

culture and even age may have a direct impact on the performance of a board. The key question is how best to regulate to promote diversity across gender, race, culture and age. The historical approach of regulating diversity by setting targets and requiring disclosure does not seem to have delivered substantial change. Is it the right time to impose mandatory requirements, or are there other alternative strategies?

Board Diversity: More than a Gender Issue?

5.3 Chairman and CEO: The controversy over board leadership structure

One of the most controversial issues in corporate governance is whether the CEO of a corporation should also serve as chairperson of the board. In theory, an independent board chair improves the ability of the board to oversee management. However, an independent chairperson is not unambiguously positive, and can lead to duplication of leadership, impair decision making, and create internal confusion - particularly when an effective dual chairperson/CEO is already in place.

In this paper the authors examine the leadership structure of publicly traded corporations and the circumstances under which they are changed.

They ask:

- what factors should the board consider in deciding whether to combine or separate board leadership?
- how can the board weigh the trade-offs between stability of leadership, efficient decision making, and decreased oversight?
- what structure should be the default setting for a corporation? and
- why do activists advocate that corporations strictly separate the roles when there is little research support for this position?

Chairman and CEO: The Controversy over Board Leadership Structure

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5.4 Hidden power of the Big Three? Passive index funds, re-concentration of corporate ownership, and new financial risk

Since 2008, a massive shift has occurred from active towards passive investment strategies. This burgeoning passive index fund industry is dominated by BlackRock, Vanguard, and State Street, which the authors call the "Big Three". This paper is the first to comprehensively map the ownership of the Big Three in the United States. The authors find that already in 40% of all listed US

corporations the Big Three together constitute the largest shareholder - and even in 88% of the S&P 500 firms. This re-concentration of ownership is unprecedented and unlike the earlier ascent of actively managed mutual funds, such as Fidelity, is likely here to stay. In contrast to active funds, the Big Three hold illiquid and permanent ownership positions, which gives them stronger incentives to actively influence corporations. The authors find that they indeed utilise coordinated voting strategies but generally vote with management, except at director (re-)elections. Private engagements with management represent an important channel through which the Big Three exert influence. Moreover, BlackRock, Vanguard, and State Street are arguably exerting hidden power because company executives are likely to internalize their objectives. Finally, the authors find indications that this development entails new forms of financial risk, including anticompetitive effects and investor herding.

Hidden Power of the Big Three? Passive Index Funds, Re-Concentration of Corporate Ownership, and New Financial Risk

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6. Recent Corporate Law Decisions

6.1 Australian liquidation prevails over US Chapter 11 proceeding in spite of s. 581 of the Corporations Act

(By James Sainty, Ashurst)

Legend International Holdings Inc. (in liquidation) v Indian Farmers Fertiliser Cooperative Ltd [2016] VSCA 151, Supreme Court of Victoria, Court of Appeal, Whelan, Ferguson and Beach JJ, 30 June 2016

(a) Summary

Randall AsJ in the Supreme Court of Victoria declined to recognise a Chapter 11 proceeding filed by Legend three days prior to the hearing of a creditors' winding up application. His Honour therefore appointed Australian liquidators to Legend. Legend appealed, arguing that despite the Chapter 11 proceeding not being recognised under the Model Law, s. 581(2) of the Corporations Act 2001 (Cth) (the Corporations Act), properly construed, obliged Australian courts to assist the American courts by refraining from making a winding up order. The appeal was unanimously dismissed by the Victorian Court of Appeal. The Court of Appeal held that s. 581(2) was discretionary and in the circumstances, there was no inherent inconsistency between the winding up order and assisting the Chapter 11 proceeding, meaning the discretion under the provision had been exercised correctly. This being so the winding up orders remained in place.

(b) Facts

An Indian farmers' cooperative and its wholly owned subsidiary (creditors) obtained an arbitral award in Singapore against Legend International Holdings Inc. (Legend), a US incorporated company. The creditors had the award enforced as a judgment against Legend in the Supreme Court of Victoria and served a demand on Legend seeking payment, before bringing winding up proceedings.

Three days prior to the hearing of the winding up application, Legend filed a US Bankruptcy Code Chapter 11 reorganisation proceeding (the Chapter 11 proceeding). It sought recognition of the Chapter 11 proceeding under the *UNCITRAL Model Law on Cross-Border Insolvency* (Model Law) and orders that the winding up application be dismissed or stayed. The Cross-Border Insolvency Act 2008 (Cth) gives the Model Law legislative force in Australia. Legend also argued that s. 581 of the Corporations Act obliged Randall AsJ to refrain from winding up Legend.

Randall AsJ dismissed Legend's application to recognise the US proceedings. His Honour found that Legend's 'centre of main interests" (COMI) was in Australia, meaning the Chapter 11 proceeding could not be recognised as a foreign main proceeding under the Model Law. Further, his Honour found that Legend did not have an "establishment" in the US. This meant that the Chapter 11 proceeding could also not be recognised as a foreign non-main proceeding under the Model Law. Randall AsJ therefore appointed Australian liquidators. Legend appealed the winding up orders.

(c) Decision

On appeal, Legend argued that despite the Chapter 11 Proceeding not being recognised under the Model Law, s. 581(2) of the Corporations Act obliged the Australian Court to act 'in aid of and auxiliary to' the US Court controlling the Chapter 11 proceeding. Legend submitted that the making of a winding up order was antithetical to the purpose of a Chapter 11 reorganisation and as such, the Australian Court had failed to comply with its obligations under s. 581(2). The USA is a prescribed country for s. 581(2) under the Corporations Regulations 2001 (Cth).

So far as is relevant, s. 581 provides as follows:

Courts to act in aid of each other.

(2) In all external administration matters, the Court:

(a) must act in aid of, and be auxiliary to, the courts of:

.

(iii) prescribed countries;

that have jurisdiction in external administration matters; .

The Court of Appeal dismissed Legend's appeal unanimously. The Court of Appeal held that s. 581(2) is a discretionary provision, and in the present case Randall AsJ had exercised the discretion correctly. The Court referred to reasoning in *Hughes v Re Hannover [1997] BCC 921*, an English Court of Appeal decision considering s. 426 of the *Insolvency Act 1986 (UK).* Section 426 is the English equivalent of s. 581.
A determinative factor from that case, adopted by the Court of Appeal, was that it would require very clear statutory language to restrict a court's functions or powers on the basis of a foreign proceeding being commenced. The Court of Appeal found that s. 581 contained no such language. Here, that meant Randall AsJ's discretion to make a winding up order was not fettered by the mere fact a Chapter 11 proceeding had been commenced.

The Court also stated that if s. 581 required the Australian court to refrain from making a winding up order, this would in effect function as an automatic stay on Australian proceedings. That result would be very favourable to Legend, notwithstanding that the Chapter 11 proceeding was unable to be recognised at all under the Model Law. Such an outcome would be anomalous.

The Court of Appeal held that all s. 581(2) obliged Randall AsJ to do was to consider what constituted aid in the circumstances, and whether such aid required him to exercise the discretion against the making of the winding up order. The Court of Appeal found no error on which to impugn the exercise of that discretion. The Court then reviewed the factors in support of making the winding up order. These included, amongst others:

- that the Chapter 11 proceeding was on foot but in very early stages, with no plan of reorganisation, and was filed after the winding up application;
- the abilities of the parties and the powers of Australian courts under the Corporations Act to manage any potential conflicts that did arise between the Australian liquidation and the Chapter 11 proceeding;
- that the Chapter 11 proceeding was not a foreign main nor a foreign non-main proceeding under the Model Law and that these findings were not appealed, meaning Legend had an insufficient nexus with the US to base a finding of COMI or even an "establishment";
- further to the above, that multiple key indicators pointed to Legend's COMI and business actually being in Australia;
- that there had been no request from the US Bankruptcy Court for assistance, and in fact, the US Bankruptcy Judge had indicated a desire to await the outcome of the Australian proceedings;
- that Legend's US counsel had acknowledged the Chapter 11 proceeding was filed to prevent the winding up; and
- the fact that it is not uncommon for there to be dual insolvency administrations where international companies are concerned and that conflicts can be mitigated.

The Court of Appeal rejected "fall back" arguments by Legend that the winding up orders should have been on terms that avoided conflict with the US proceeding, so the liquidation became the ancillary proceeding. The Court stated that a majority of Legend's creditors were Australian based and that moreover, distribution was some time away, rendering directions to the liquidators to remit assets to the US unnecessary at the time of judgment.

The Court of Appeal therefore dismissed the appeal. The winding up orders remained in place. Applications by the liquidators and a director of Legend seeking directions in relation to the US proceeding were to be heard by the trial division in coming days.

6.2 A "degree of unreasonableness" in a liquidator's conduct led to personal liability for costs

(By Meagan Ryan, MinterEllison)

Re J A Westaway Pty Limited (in liq.) [2016] NSWSC 868, Supreme Court of New South Wales, Black J, 24 June 2016

(a) Summary

This case concerned who was responsible for costs arising from an interlocutory proceeding brought by a creditor of a company in liquidation for interlocutory relief to restrain the convening of the final meeting of members and creditors of that company. The liquidator was found to have acted with a degree of unreasonableness in calling the meeting and his actions were found to have forced the plaintiff to bring its interlocutory application. Accordingly, the liquidator was personally liable for the costs of the interlocutory application.

(b) Facts

On 9 October 2015, Mr Sydney Doneley, on behalf of The Owners - Strata Plan No 79215 (the Owners Corporation) commenced proceedings under ss. 509, 511 and 1324 of the Corporations Act 2001 (Cth) (the Corporations Act) and s. 66 of the Supreme Court Act 1970 (NSW) against Mr Sule Arnautovic, the liquidator (the liquidator) of J A Westaway Pty Limited (the Company).

Before commencing proceedings, the Owners Corporations had previously given the liquidator notice of its intention to lodge a proof of debt. However, seven weeks after this notice of intention was given, and before the Owners Corporation had lodged its proof of debt, the liquidator gave notice to the creditors of the Company to convene the final notice of meeting of the Company's members. The liquidator had not inquired with the Owners Corporation as to whether it was still going to submit a proof of debt, rather the liquidator presumed that the Owners

Corporation would not proceed with submitting a proof of debt, and did not send a notice of the final meeting to the Owners Corporation. The Owners Corporation subsequently submitted a proof of debt. However, the liquidator did not adjudicate the proof of debt prior to the final meeting and did not seek to adjourn the final meeting.

Section 509 of the Corporations Act requires a liquidator to convene a general meeting of the creditors and members "[a]s soon as the affairs of the company are fully wound up...for the purpose of laying before it the account and giving any explanation of the account".

The Owners Corporation was successful in seeking an interim order restraining the final meeting of members on the basis there was a seriously arguable case to answer that the affairs of the Company had not been determined so as to permit a final meeting to be convened and a balance of convenience favoured an order restraining the meeting being convened.

On 18 March 2016 the interlocutory relief restraining the meeting from being convened was continued by consent. On 11 April 2016 the proceedings were dismissed by consent on the condition that the proof of debt submitted by the Owners Corporation be admitted and subject to the determination of the issue of costs of the proceedings.

Black J considered two issues in reaching his conclusion in relation to the costs of the proceedings. First, whether or not an order for costs should be made in favour of the plaintiff. Second, whether or not the order for costs should be made against the liquidator personally or should be limited to the amount of the Company's assets available to meet such an order with the result that such an order would likely be fruitless.

(c) Decision

(i) Should an order for costs be made in favour of the plaintiff?

The court has discretion as to whether or not to make an order for costs of proceedings which are dismissed with the consent of the parties. Black J relied on the principle articulated by Hallen AsJ in *McNamara v Bao San* [2010] NSWSC 809, [12], that a relevant consideration was "whether the plaintiff acted reasonably in commencing the proceedings and whether the defendant acted reasonably in defending them, and that all relevant circumstances, and not just the fact of dismissal should be considered".

Black J found that the Owners Corporation was entitled to an order for costs. This was on the basis that its application was "reasonable and necessary" in the circumstances where it was apparent the liquidator was not going to adjourn the final meeting of creditors to determine the proof of debt submitted by the Owners Corporation. Absent the application, the Owners Corporation faced a real risk that the final meeting of creditors would have proceeded and the Owners Corporation would have lost its opportunity to have its proof of debt determined. A further

factor was that the Owners Corporation had been successful in its application for interim relief.

(ii) Should the costs order be made against the liquidator personally?

In determining whether or not the liquidator should be personally liable for the costs order, Black J noted the principle identified by the Court of Appeal in *Silvia v Brodyn Pty Ltd* [2007] NSWCA 55, [52]-[54], that a liquidator will be personally liable for a costs award where they have acted unreasonably in defending litigation, otherwise the liquidator will ordinarily not incur personal liability beyond the amount of the Company's assets available for the purpose of meeting a costs award.

The plaintiff was not prepared to address the question of whether or not the costs order should be made against the liquidator personally in the course of submissions. The plaintiff was permitted to make written submissions to establish the basis for a personal costs order and the liquidator was permitted to submit a response.

Black J concluded that the liquidator's conduct had a degree of unreasonableness sufficient to support an order for costs of the initial application for interlocutory relief against the liquidator personally. The unreasonable conduct included that it was unreasonable for the liquidator to call the final meeting of creditors without first making an inquiry with the Owners Corporation about whether or not it still intended to submit a proof of debt. This was because the lodgement of proof of debt had been foreshadowed and the liquidator could not have thought the affairs of the Company were fully wound up without first taking steps to confirm the intention of the Owners Corporation. Furthermore, the liquidator did not give the Owners Corporation notice of the meeting and the liquidator did not respond to the initial concerns of the Owners Corporation about the meeting when the liquidator could have indicated that he would not oppose Court relief in respect of the meeting.

Accordingly, Black J ordered the liquidator pay the costs of, and incidental to, the interlocutory application, and that the costs not be limited to the amount of the Company's assets available for the purpose of meeting a costs award.

In relation to the application for costs, Black J ordered the liquidator to pay the costs of the application limited to the amount of the Company's assets available for the purpose of meeting a costs award. The liquidator was not personally liable as the plaintiff had increased the time and cost incurred by both parties in pursuit of the claim for costs and had not been prepared to address the question of personal liability of costs at the time of the application.

6.3 Insider trading charge results in term of imprisonment on grounds of general deterrence and equality of sentencing

(By Alex Moores and Kiran Marfatia, DLA Piper)

R v Curtis (No 3) [2016] NSWSC 866, Supreme Court of New South Wales, McCallum J, 24 June 2016

(a) Summary

Mr Oliver Curtis was convicted of conspiracy to commit an offence of insider procuring pursuant to ss. 1311(1)(a) and 1043A(1)(d) of the Corporations Act 2001 (Cth) (the Corporations Act). Investigations by ASIC revealed that Mr Curtis, acting on information provided by a co-conspirator, Mr John Hartman, carried out 45 trades over a period of 14 months which generated a net profit of approximately $1.43 million. Mr Curtis was sentenced to two years imprisonment, with a recognisance release order directing his release after serving one year of the sentence.

In its judgment, the Supreme Court of New South Wales (the Court) held that "white-collar crime is a field in which, perhaps more than any other, offending is often a choice freely made by well-educated people from privileged backgrounds, prompted by greed rather than the more pernicious influences of poverty, mental illness or addiction that grip other communities. The threat of being sent to gaol, provided it is perceived as a real threat and not one judges will hesitate to enforce, is likely to operate as a powerful deterrent to men and women of business".

(b) Facts

(i) Circumstances of the offence

Mr Curtis' co-conspirator, Mr Hartman, had access to inside information about the trading intentions of his employer, Orion Asset Management Ltd (Orion). It was Mr Hartman's job at Orion to act on specific purchase orders given by senior managers. However, it was Mr Hartman's discretion as to when he placed the order, intending for this to ensure shares were purchased at their lowest price and sold at their highest price. Mr Hartman and Mr Curtis equally conspired to use Mr Hartman's position in the markets to enable Mr Curtis to acquire or dispose of Contracts for Difference (CFD), front-running Orion's trading. Mr Curtis set up a specific CFD trading account with CMC Markets Asia Pacific Pty Ltd, a company that trades in CFDs. The account was set up in the name of a company of which Mr Curtis was the sole director, and Mr Curtis provided the funds to begin the trading.

Mr Hartman gave evidence that Mr Curtis proposed the two communicate using Blackberry phones, purchased by Mr Curtis, relying on encrypted PIN messaging to hide their communications. There was no electronic record of the content of the

PIN messages but Mr Curtis did not contest the evidence of Mr Hartman that such messages were sent.

Between approximately 1 May 2007 and 30 June 2008, Mr Curtis carried out 45 separate trades, whereby he would purchase the CFD before Orion began trading, and then would sell before Orion trading finished. Allegedly unbeknownst to Mr Curtis, Mr Hartman traded more aggressively than he otherwise would but for his position so as to increase the price of the relevant shares within a short time frame. By trading in CFDs, the two were able to make substantial profits within a short period of time from relatively small movements in the price of the underlying share. This process resulted in a net profit of approximately $1.43 million, which was distributed between the two. The Court denied a claim by Mr Curtis, referring to it as the "most ambitious" of his submissions, that his trading was not undertaken for immediate personal gain since Mr Hartman received the first distribution of profits in the form of a car.

Mr Curtis' conduct was first reported to ASIC by Mr Hartman in early 2009, but he was not charged until 2013. The delay between 2009 and 2016, when Mr Curtis was formally sentenced, was contributed to significantly by Mr Curtis' choice not to cooperate with ASIC to any degree until close to the trial date, but the Court ultimately did not attribute responsibility or blame to either party. Mr Curtis was charged with conspiracy to commit an offence of insider procuring pursuant to ss. 1311(1)(a) and 1043A(1)(d) of the Corporations Act.

(ii) Circumstances of the offender

Mr Curtis was 21 years old when the offence was committed (he was 30 at the time of sentencing). At the time of sentencing, Mr Curtis had a wife and young son, and he had no prior convictions. Mr Curtis had exceptional character references citing a low-to-zero chance of reoffending and demonstrating a person of good character. He made full reparations for the loss caused by the conspiracy. However, throughout ASIC's investigation, Mr Curtis refused to co-operate which significantly delayed the process. It was only during the trial, whilst facing substantial evidence against himself, that he began to co-operate.

(c) Decision

Mr Curtis was sentenced to a term of imprisonment for two years with a recognisance release order directing that he be released after serving one year of that sentence. The Court made several comments in relation to sentencing considerations based on both the general nature of the offence and the personal circumstances of the offender.

(i) The need for deterrence

The Court stated that there is a need to deter young adults from taking the significant financial advantages offered by the contemporary business world. The youth and relative immaturity of Mr Curtis did not lessen the importance of general deterrence. He had been operating in the adult sphere of business and

commerce and was himself educated and worldly. Further, the fact that people of otherwise good character and compelling personal circumstances are tempted to commit offences of this kind calls for the imposition of deterrent sentences.

This was despite the fact that personal deterrence was unnecessary in this case, due to Mr Curtis' low propensity to re-offend. The Court held that it must be astute to dispel any perception that white collar offenders and other classes of people who commit offences of dishonesty are treated unequally. On this basis, the Court deemed it necessary to impose a sentence of imprisonment inclusive of a portion to be served in custody, stating that "any lesser sentence would [not] adequately reflect the seriousness of the offence".

(ii) Sentencing considerations

Various issues were raised in relation to the effect on Mr Curtis and the Court, while accepting that in some cases the factors could be weighted more highly, was not convinced by several arguments on this set of facts.

The Court held that:

- the character evidence should be reduced in weight, due to the extended period of time over which Mr Curtis' deliberate offences occurred;
- exceptional circumstances were not made out to take into account the effect that a sentence would have on Mr Curtis' family. The family in this case was well-resourced and better placed than many to manage his imprisonment;
- submissions claiming a credit due to Mr Curtis' extended bail of 3 1/2 years being unduly restrictive on his liberty should be rejected. Irrespective of the reason for the trial delay, there was no basis for a curtailment of liberty argument since Mr Curtis travelled overseas 24 times whilst on bail, which was in contrast to cases where the accused suffered more obvious and significant disruption;
- small concessions should be made to Mr Curtis for his suffering due to adverse media reporting, but the degree was not at the same level as other cases; and
- there would be no "extra-curial" punishment due to the loss of his professional reputation. Significant weight was not given because Mr Curtis' father had acknowledged he would "always look after him".

6.4 Registrable security interests found not to derive from undertakings as to damages or from non-consensual dealings

(By Alex Moores, DLA Piper)

National Australia Bank v Garrett [2016] FCA 714, Federal Court of Australia, Beach J, 16 June 2016

(a) Summary

Mr Garrett and OenoViva (UK & Ireland) Pty Ltd, a company purportedly managed by Mr Garrett (collectively the Respondents), lodged an application for registration of a security interest on the Personal Property Securities Register (PPSR) pursuant to the Personal Property Securities Act 2009 (Cth) (the PPSA). The security was registered against National Australia Bank Limited (NAB) with reference to a document titled the *Distributor License Purchase Vendor Finance Performance Security Deed* under which NAB allegedly granted the interest (Security Deed), which had arisen from an earlier proceeding in 2004 where NAB had made an undertaking as to damages (the 2004 Proceeding). Mr Garrett also claimed to be the "managing controller" of the property and sent numerous bills of exchange to NAB alleging NAB owed payment of over $30 billion.

The Federal Court of Australia (the Court) held that a security interest could not be registered in favour of the Respondents against NAB as the right does not arise from previous undertakings as to damages. In addition, Mr Garrett was an undischarged bankrupt and therefore did not have the right to register interests based on previous dealings, or the right to be a "managing controller" under the Corporations Act 2001 (Cth) (the Corporations Act). Finally, Mr Garrett's conduct in sending numerous bills of exchange to NAB was seen as vexatious. The Court ordered that the security interest registration be removed from the PPSR and the Respondents be retrained under the PPSA from any further registrations in respect of NAB property and from delivering any further bills of exchange to NAB.

(b) Facts

In April 2016, the Respondents caused a financing statement to be registered on the PPSR in respect of property of NAB and Treasury Wine Estate Vintners Ltd. This was recorded as "all present and after-acquired property - no exceptions" collateral following an email from Mr Garrett to NAB stating that the right to register the security arose from a Security Deed purportedly granted by NAB to the Trustees. Relevant to Mr Garrett's contention was that the Security Deed stated that the "charge is registered pursuant to the undertaking as to loss costs and damage given by the Chargee [NAB] in SCI-2004-127; Andrew Garrett Wines Resorts Pty Ltd v National Australia Bank Limited."

The Security Deed was not executed by NAB and it argued that it was simply created by Mr Garrett based on the misconceived foundation that an undertaking as to damages given in the 2004 Proceeding could somehow give rise to a security interest. As such NAB issued an amendment demand to Mr Garrett denying any agreement to the effect of the Security Deed. Mr Garrett refused to discharge the registration and instead sent NAB two documents titled *Deed of Appointment of Controller* and a *Notice of Crystallisation of Charges/Seizure of Assets* which together claimed to have the effect of appointing himself as the "managing

controller" of all NAB property that was subject to the security interest. NAB refuted this claim.

(c) Decision

The main point to be decided was in relation to whether the security interest was validly registered, but there were also several other issues to be resolved relating to Mr Garrett's purported appointment as managing controller of the security interest and his service of numerous bills of exchange.

(i) Validity of the security interest

The basis for the claim of a security interest was Mr Garrett's belief that one arose from an undertaking as to damages that was provided by NAB in the 2004 Proceeding. The key part of the 2004 Proceeding was the statement by Besanko J that "the defendant, National Australia Bank Ltd, by counsel, undertakes to abide by any order the Court or a Judge may make as to damages in case the Court or a Judge shall hereafter be of the opinion that any person shall have sustained any loss or damage by reason of these orders and undertakings which the defendant ought to pay". At the time of the 2004 Proceeding, there was no requirement that this undertaking be accompanied by a security interest. Ultimately, NAB was successful in the 2004 Proceeding and no orders for damages were made.

The Court in this case held that an undertaking as to damages cannot be a security interest for the purposes of the PPSA for several reasons:

- first, the undertakings were made to the court in the proceedings, not to the other parties, and the undertakings were not a chose in action;
- second, the undertakings were not required to be accompanied by a security interest and at any rate the proceedings were dismissed and no damages were awarded;
- third, Mr Garrett by the time of this case was an undischarged bankrupt and accordingly all rights in relation to earlier undertakings would vest in his bankruptcy trustee; and
- finally, given Mr Garrett's generally litigious history in relation to NAB, it is likely that he will continue to lodge similar documents unless restrained.

In addition to these reasons, the Court acknowledged that the Security Deed had not been executed by NAB and, regardless of the other alleged grounds that gave rise to an interest or whether an interest could generally have arisen from a document of a similar type, declared that the Security Deed was void and had no effect.

(ii) Appointment as Managing Controller

Mr Garrett claimed to be the managing controller of NAB in respect of the assets that are the subject of the security interest. The Corporations Act defines managing controller, in relation to property of a corporation, to mean either a

receiver and manager of that property or any other controller of that property who has functions or powers in connection with managing the corporation.

The Court found that, under Part 5.2 of the Corporations Act, Mr Garrett had not been validly appointed. The main reason was that there was found to be no valid security interest and therefore no foundation for appointment. Mr Garrett was also an undischarged bankrupt, and accordingly under s. 206B(3) of the Corporations Act he was disqualified from managing a corporation. His conduct and appointment, if otherwise valid, was held to be likely an infringement of s. 206A(1)(a) and (b) of the Corporations Act given the width of the assets said to be the subject of the security interest and the powers otherwise given to a managing controller. The Court declared his appointment invalid and ordered that he be restrained from lodging any document to register or acting in any way that suggested his appointment as a managing controller.

(iii) Vexatious bills of exchange

Mr Garrett, throughout March and April 2016, delivered numerous bills of exchange to NAB branches, asserting that they had been accepted on delivery. In May 2015, NAB wrote to Mr Garrett and asked him to desist. Despite this request, Mr Garrett issued a subsequent bill of exchange in the amount of $25 billion, taking the total amount for which he was claiming to be the drawer to over $30 billion. The Court held that the presentation of these bills of exchange at NAB branches caused a serious inconvenience and cost to NAB staff forced to deal with them, stating that Mr Garrett's conduct was "not only fanciful, but it also constituted misrepresentation and misleading or deceptive conduct". It was found to be irrelevant whether or not the NAB staff were actually deceived by the documents, the conduct in itself was sufficient for an injunction against the behaviour. Mr Garrett was also subject to various other vexatious litigant orders made by other Justices of the Court.

6.5 When can a company recover property transferred without authority?

(By Katrina Sleiman and Frederick Jolley, Corrs Chambers Westgarth)

Great Investments Ltd v Warner [2016] FCAFC 85, Federal Court of Australia, Full Court, Jagot, Edelman and Moshinsky JJ, 14 June 2016

(a) Summary

The appellants, recipients of $6 million in bonds from Bellpac Pty Ltd (Bellpac), sought to overturn a decision of the Federal Court allowing Bellpac's liquidators to recover the bonds. The appellants received the bonds after one of Bellpac's directors, a Mr Wong, transferred them as payment for his personal debts.

At both first instance and on appeal, the appellants relied on three arguments as to why they should retain the bonds:

- the bonds were transferred under a power of attorney (POA) which allowed Mr Wong to deal with Bellpac's assets for his personal benefit, and to Bellpac's detriment;
- the appellants were entitled to rely on ss. 128 and 129 of the Corporations Act 2001 (Cth) (the Corporations Act) which prevented Bellpac denying that Mr Wong had authority to effect the transfers; and
- the appellants were *bona fide* purchasers for value without notice.

At first instance the primary judge rejected each of the appellants' submissions, finding for the liquidators on two alternative basis. The first was a form of strict liability that the appellants had to Bellpac as recipients of company property transferred without authority. The second was that the appellants had knowingly received property in breach of a fiduciary duty owed by Mr Wong to Bellpac.

Upholding the primary judge's decision, the Full Court rejected the appellants' three arguments. However, the Court found that the appellants could only be liable on the strict liability basis. Issues of knowing receipt did not arise where a company sought to recover property transferred to a recipient without authority. Separately, the Court found that the liquidators would have been entitled to the bonds as a form of relief under s. 588FF of the Corporations Act.

(b) Facts

Mr Wong carried out various transfers to the appellants of bonds received by Bellpac from a company called Gujarat NRE Coking Coal Limited. In each case the transfers were recorded in the company's register of bond holders.

The primary judge found that the recipients were aware that the transfers were from Bellpac rather than Mr Wong personally and that the transfers were made as payment for Mr Wong's personal debts.

(c) Decision

The Court distinguished the circumstances in which a company could bring an action for knowing receipt, from those where it was entitled to claim that the recipient had a strict liability to the company. The Court then discussed the various defences raised by the appellants.

(i) When can a company bring an action in knowing receipt?

At first instance, the primary judge found the bond recipients liable to Bellpac for knowing receipt under the first limb of *Barnes v Addy (1874) LR 9* Ch. App 244. During the appeal, counsel for the appellants conceded that if the transfer was without authority then questions of knowing receipt would not apply; the appellants could only succeed on the appeal if they could establish that they were *bona fide* purchasers for value without notice. Conversely, if the transfers were

made with authority then the question would be whether the transfers could be rescinded; again issues of knowing receipt would not arise. The Court accepted this concession.

An action for knowing receipt is necessary where a company seeks equitable compensation or an account of profits from the recipient of company property. Where the company seeks to recover the transferred property, or where the transfer occurs without authority, issues of knowing receipt do not arise; the issue will be the rescission and re-vesting of a benefit received by the recipient. The Court referred to these circumstances as a disposition without authority.

In this case, the transfers from Mr Wong occurred without authority and without a contract. The Court explained that Bellpac was entitled to either a proprietary claim, if the appellants still possessed the bonds, or a personal claim for the value of the bonds if they did not. The Court traced this action to the decision of *Harrison v Harrison (1740) 2 Atk 121*. The Court also noted a recent application of the principle in *Prestige Lifting Services Pty Ltd v Williams* [2015] FCA 1063.

In this case, Bellpac was entitled to seek a transfer of the bonds from the appellants. Specifically, the Court upheld the primary judge's order that the bonds be transferred to Bellpac, and that they were held on constructive trust by the recipients until that occurred. The Court explained that the phrase "constructive trust" was used in this context as a shorthand for an order akin to orders of conveyance, as stated in *Giumelli v Giumelli* (1999) 196 CLR 101.

(iii) The appellants' defences

The Court then considered the appellants' defences, dividing them into two issues:

- whether Mr Wong had authority to transfer the bonds; and
- whether the defence of *bona fide* purchase for value without notice applied.

The Court rejected a submission that the POA allowed Mr Wong to dispose of Bellpac's assets for his benefit. The submission relied on a clause which allowed the power to be exercised despite any personal interest Mr Wong had. The Court found against this construction of the power on four bases:

- the clause which allowed Mr Wong to enter a transaction from which he benefits was under the heading "declaration" in the POA. The clause did not grant any power to Mr Wong and so cannot be relied on as authority for Mr Wong to make gifts of the principal's property to himself;
- the appellants' construction contravenes an established line of authority which states that a POA should not be construed as authorising the attorney to deal with the principal's property for his own benefit;
- the POA was granted by two directors of Bellpac to be used "in good faith in the best interests of the corporation" as per s. 181(1)(a) of the Corporations Act. This context opposes the appellants' construction; and

- a POA is to be construed strictly in favour of the principal.

Having found that Mr Wong's POA did not authorise the transfers, the Court considered whether he had authority under ss. 128 or 129(4) of the Corporations Act. Together, those sections allow an entity dealing with a corporation to assume that its officers have properly performed their duties to the corporation. The appellants claimed that these sections entitled them to assume that Mr Wong had the authority to deal with Bellpac's assets as he did. The Court rejected this submission, holding that s. 129(4) (when read with s. 128) only permits assumptions to be made about the performance of an officer's duties, not about their authority. A right to assume that Mr Wong properly performed his duties did not, the Court held, overcome his lack of authority.

The Court then considered the defence of *bona fide* purchase for value without notice. The Court initially stated that the defence may not be available in a two party transaction, having generally been accepted as a defence for a third party. However, no case was found which explicitly decided that the doctrine cannot apply where the applicants rights were purchased from the applicant, rather than a third party.

Regarding the issue of "notice", while the authorities are not wholly uniform in relation to the degree of knowledge which is sufficient, the Court observed that the dominant position appears to be that any of the five degrees of knowledge (referred to in *Farah Constructions Pty Ltd v Say-Dee Pty Ltd (2007) 230 CLR 89* at 174) negates the requirement of "without notice".

The Court was satisfied that the recipients were aware that the transfers were from Bellpac not Mr Wong. The transfers were also in payment of Mr Wong's personal debts and so no value or consideration was received by Bellpac. The Court accepted that the appellants were not *bona fide* purchasers for value without notice.

6.6 NRMA v Parker affirmed: shareholders are unable to pass resolutions which express an opinion on the exercise of a Board's powers

(By Nina Janic and Bradley Montag, Clayton Utz)

Australasian Centre for Corporate Responsibility v Commonwealth Bank of Australia, [2016] FCACF 80, Federal Court of Australia, Full Court, Allsop CJ, Foster and Gleeson JJ, 10 June 2016

(a) Summary

Pursuant to s. 249O of the Corporations Act 2001 (Cth) (the Corporations Act), the Australasian Centre for Corporate Responsibility (ACCR) issued a notice to

the Commonwealth Bank of Australia (CBA) on behalf of more than 100 CBA shareholders, tabling three alternative resolutions to be moved at CBA's 2014 annual general meeting (AGM). CBA included only one of those resolutions in its notice of meeting. ACCR applied to the court for a declaration that all of the resolutions could be validly moved. At first instance, Davies J held that ACCR had failed to identify a constitutional or statutory power under which shareholders could validly pass the proposed resolutions. ACCR appealed on a number of grounds, but the Full Court of the Federal Court unanimously dismissed the appeal.

(b) Facts

ACCR represented more than 100 voting members of CBA. In 2014, ACCR gave notice to CBA under s. 249N of the Corporations Act proposing three resolutions, set out in order of ACCR's preference, to be put at the 2014 AGM. The first two resolutions were ordinary resolutions expressing "opinions or concerns" of the shareholders in respect of environmental matters. The third was a special resolution to amend CBA's constitution to require the directors to annually report to shareholders their assessment of the quantum of greenhouse gases that CBA is responsible for financing. Only the third (ACCR's least preferred) resolution was included in the notice of AGM. CBA argued that the first two resolutions could not be put to shareholders as they related to matters that were solely "within the purview of the Board and management of the bank".

At first instance, Davies J rejected ACCR's argument that the two disputed resolutions "could validly be moved" at the AGM. Davies J applied the principles from *National Roads & Motorists' Association v Parker (1986) 6 NSWLR 517* (Parker) in reaching her decision that, because ACCR's proposed resolutions related to powers of management (vested in CBA's board) and were not referable to any powers of CBA's shareholders in a general meeting, CBA was not required to put the proposed resolutions to its shareholders.

ACCR appealed on a number of grounds, including that the trial judge erred in:

- concluding that the decision in Parker meant that it was necessary to identify a source of power for shareholders at general meeting to pass a proposed resolution before such a resolution could be put; and
- rejecting s. 250R(1) of the Corporations Act as a source of power sufficient to enable the resolutions to be put.

(c) Decision

(i) Can a members' resolution which is not binding and has no legal effect be validly moved at an AGM?

ACCR acknowledged that the proposed resolutions would not be legally binding on CBA, but submitted that, regardless of whether the resolutions were capable of

binding CBA, shareholders have the power to validly move such non-binding resolutions unless that power has been expressly limited or removed.

ACCR attempted to rely on the US case of *Auer v Dressel (1954) 306 NY 427* as authority for the proposition that the purpose of the shareholder resolutions was to increase shareholder participation and make directors aware of shareholder opinions. The Court rejected this submission and confirmed that the correct approach in Australia was the position taken in *Isle of Wight Railway Co v Tahourdin (1883) 25* Ch. D 320, and reaffirmed in *Clifton v Mount Morgan Limited (1940) 40 SR (NSW) 31*, which "tend[s] against the existence of a power vested in shareholders in general meeting to pass an ineffective resolution".

The Court affirmed the primary judge's interpretation of Parker that "shareholders in general meeting do not have a role to play in the exercise of powers vested exclusively in the board".

(ii) Can the resolutions be "validly put" to the members?

ACCR submitted that the resolutions could be "validly put", and therefore meet the requirements of s. 249 of the Corporations Act, because (in the alternative):

- shareholders had a legitimate interest in the substance of the resolutions;
- the resolutions could be made in the exercise of CBA's "plenary power";
- there was an implied power of the company to do so; or
- s. 250R confers power on shareholders to put resolutions relating to the management of a company.

The Court rejected the first contention on the basis that the legitimate interests of shareholders in a company's management are distinct interests to those of the company. Any act of the company, including a resolution, must be founded in statute or the company's constitution. The Court noted that CBA's constitution included a provision materially indistinguishable from s. 198A of the Corporations Act, providing that the directors are tasked with managing the company unless the directors' powers are vested in the members under the company's constitution or statute. This was not the case in CBA's constitution.

Referring to *Winthrop Investments Ltd v Winns Ltd [1975] 2 NSWLR 666* and s. 124(1) of the Corporations Act, ACCR argued that "if an individual can express an opinion, so can a company". The Court disagreed, and explained that there is nothing in the legal powers or capacity of an individual which by analogy would permit CBA to express an opinion relating to CBA's management by means of a resolution of CBA's shareholders.

The Court rejected the appellant's other arguments. The Court held that the appellant failed to establish any implied power for putting forward the resolutions. Similarly, the Court rejected the appellant's submission that s. 250R of the Corporations Act confers an "express power" on shareholders in a general meeting to pass resolutions relating to the management of the company. The Court clarified

that this section relates only to the subject matter of the meeting itself, and does not confer any power on the shareholders.

(iii) Did ACCR give proper notice pursuant to s. 249 of the Corporations Act?

ACCR's letter (setting out the proposed resolutions) gave CBA the discretion to decide which resolution to put forward at the AGM. Accordingly, the Court held that the letter was not a notice within the meaning of s. 249N of the Corporations Act to the extent that it concerned the two disputed resolutions. This reaffirmed Davies J's decision at first instance.

(iv) Were the statements accompanying the notice of members' resolution ultra vires?

CBA's notice of meeting included a statement provided by ACCR in support of the resolution, and a statement by the board of CBA recommending that shareholders vote against the resolution. ACCR argued that CBA's statement went beyond what was required to fully and fairly inform shareholders; however, the Court rejected this argument on the basis that there was no legal foundation to object to the materials provided by directors in the circumstances.

6.7 Could resolutions be proposed by securityholders that the manager of stapled investments be removed?

(By Sophie Duxson, Ashurst)

Aveo Group Limited v State Street Australia Pty Ltd in its capacity as Custodian for Retail Employees Superannuation Pty Ltd (Trustee) [2016] FCAFC 81, Federal Court of Australia, Full Court, Allsop CJ, Foster and Gleeson JJ, 10 June 2016

(a) Summary

The Federal Court dismissed an appeal from a decision in which the primary judge had found that a trust entity had not erred in calling a meeting of the members of the entities in a stapled investment, in which it held securities, in order to propose a resolution that the manager of the stapled investment be removed.

(b) Facts

The first and second respondents were the custodian and trustee of the Retail Employees Superannuation Trust (REST), which held securities in a "stapled investment" known as Retirement Villages Group (RVG). RVG comprised three entities, who were the third, fourth and fifth respondent (the stapled entities). The second appellant, Retirement Villages Group Management Pty Ltd (RVGM) was responsible for the management of the stapled investment under an Advisory

Services Deed (ASD). The first appellant, Aveo, owned 38.79% of the securities in the stapled investment, RVG, and controlled RVGM.

REST had become dissatisfied with the management of the stapled investment and wanted to remove RVGM as manager. To do so, it called meetings of members of the stapled entities under s.s 249F and 252D of the Corporations Act 2001 (Cth) (the Corporations Act), in which it was proposed that they pass identical "special resolutions" under s. 9 of the Corporations Act, removing RVGM and terminating its appointment under the ASD.

The first and second appellants sought declaratory relief because of the alleged invalidity of the resolutions proposed at the meetings. The primary judge dismissed the application and the appellants appealed that decision.

There were two issues for the Federal Court to resolve:

- whether REST was lawfully allowed to call the meetings in order to propose the resolution, or whether only the board of directors of the stapled entities could call meetings of securityholders for such a purpose; and
- whether the resolution fell under the definition of "special resolution" contained in s. 9 of the Corporations Act.

(i) The Securityholders Deed

The constitutions of the stapled entities were subject to the terms of a Securityholders Deed (SHD) to which the three stapled entities, as well as RVGM and Aveo, were parties. As REST owned securities in RVG, it was granted rights contained in the SHD. Clause 3.7(n)(c) of the SHD provided for consultation with representatives of securityholders about "Securityholder Reserved Matters". For the purposes of this matter, the relevant clauses were the following:

- Clause 5.1 of the SHD, which provided that proposals by stapled entities in respect of Securityholder Reserved Matters be approved by a resolution which passed with the requisite Super Majority as required in Schedule 1;
- Clause 5.2, which provided that those matters which must be approved by securityholders in the stapled entities but which were not Securityholder Reserved Matters had to be approved in accordance with the constitutions of each stapled entity; and
- Clause 5.4, which provided for circumstances in which meetings could be called to pass resolutions to terminate the ASD in accordance with cl. 13.3(a)(vi) of the ASD.

(ii) The Advisory Services Deed

Under cl. 13.3(a)(vi) of the ASD, to which all three stapled entities and RVGM were parties, RVGM's appointment could only be terminated by the stapled entities if they passed a resolution to do so with a vote of at least 75% of total votes, providing RVGM and Aveo were entitled to vote at the meeting. Under cl. 13.3(a)(vii), if RVGM failed a benchmark test three consecutive times, and a

Super Majority resolution was passed to remove RVGM at a meeting at which RVGM and Aveo were not entitled to vote, RVGM could be removed. The respondents relied on the second method, under cl. 13.3(a)(vii), as justifying the removal of RVGM.

(c) Decision

The Federal Court dismissed the appeal.

(i) Could the meeting be called for the proposal of the resolutions in question?

In arguing that the meeting was invalidly called, the appellants pointed to the fact that cl. 13.3(a)(vii) contained no express power in the SHD for securityholders to call a general meeting and put a resolution of this nature, unlike cl. 13.3(a)(vi) (the express power is contained in cl. 5.4 of the SHD). They also argued that cll. 5.1 and 5.2 of the SHD, in using the words "be approved", suggested that only the board of one of the stapled entities could institute or call for a resolution for the removal of RVGM. However, the Court held that REST was able to call the meeting for the proposed resolution for the following reasons:

- under cl. 4.2 of the SHD, the power to call and arrange to hold general meetings was not exclusively vested in the directors (at [56]). Securityholders were authorised to request the calling of a meeting. There was no reason why cll. 5.1 and 5.2 should detract from the right of securityholders to propose resolutions within the scope of their powers (at [56]);
- the power in cl. 4.2 was limited to meetings to consider resolutions which would not interfere with the directors' exercise of their power, which were not futile and would not be ineffective. The proposed resolution would not have amounted to such an interference and it was not futile - if passed, it would add to the directors' powers by empowering them to terminate RVGM's appointment under the ASD (at [58]). The Court also held that the resolutions would have efficacy by reason of cl. 13.3(a)(vii) (at [59]); and
- the Court accepted the appellants' argument that the mere existence of a power to convene a meeting did not suffice to provide a constitutional basis for a shareholders' resolution. However it held that the ASD provided that it was part of the function of the securityholders to pass a resolution to remove RVGM in accordance with cl. 13.3(a)(vii).

(ii) Was the proposed resolution a "special resolution" within the meaning of s. 9 of the Corporations Act?

- the appellants argued that because the constitutions of the stapled entities drew a deliberate distinction between "special" and "Super Majority" resolutions, s. 252D of the Corporations Act could not provide the mechanism to propose a "Super Majority" resolution;
- the Court held that this concern could be resolved by the form of the relevant notice. The notice for the meeting of the members of the stapled

entities provided that the business of the meeting was to consider "a special resolution". There was no reason to doubt the intention of REST that the resolution be proposed "as a special resolution" within the meaning of the Corporations Act (at [67]); and
- Section 252 provided for a meeting to consider and vote on a proposed special resolution, where the constitution of the registered scheme required a higher threshold than that required for a special resolution. There was nothing in the language or purpose of s. 252D which suggested that the particular constitutional requirements of a scheme qualified members' rights to call a meeting in accordance with s. 252D (at [68]).

(iii) Other matters

The Court accepted two grounds of the notice of appeal, which related to factual errors in the judgment of the primary judge. As these matters were of no significance on the appeal, success on these points did not lead to success on the appeal itself.

6.8 Employers' vicarious liability for the fraudulent acts of employees

(By Sai Ma, Herbert Smith Freehills)

Pioneer Mortgage Services Pty Ltd v Columbus Capital Pty Ltd [2016] FCAFC 78, Federal Court of Australia, Full Court, Davies, Gleeson and Edelman JJ, 9 June 2016

(a) Summary

The Full Court of the Federal Court of Australia has affirmed that an employer can be liable for the fraudulent acts of its employees, even where those acts are unauthorised. A mortgage management company employee fraudulently transferred customer funds into her husband's account. The fraud was undetected for six years. The Full Court held that the company breached its contractual obligations to maintain procedures that would be taken by a reasonably prudent mortgagee. Furthermore, the company was held to be vicariously liable for the acts and liability of the employee. The judgment is significant in that it suggests a broader scope for holding a company liable for the fraudulent - albeit unauthorised - acts of its employees.

(b) Facts

Pioneer Mortgage Services Pty Ltd (Pioneer) and Columbus Capital Pty Ltd (Columbus) were parties to several deeds whereby Pioneer originated mortgages and Columbus funded them. Ms Tupeia Dando was a manager at Pioneer. She was authorised to make customer redraws. Between 2006 and 2013, Dando redrew

funds from three customer accounts without the customers' consent and deposited the funds into her husband's account. Each transaction was for less than $10,000. The fraudulent redraws went undetected by Pioneer until 2014.

The case was first heard by the Federal Court. The primary judge held that Pioneer was liable for Dando's fraud on three grounds:

1. breach of contract;
2. vicarious liability for the acts of its employee; and
3. breach of consumer law for misleading or deceptive representations made by its employee on its behalf.

(c) Decision

Pioneer appealed the Federal Court's decision on the basis that the primary judge had erred in finding it liable on each cause of action. The Full Federal Court dismissed the appeal on all three grounds.

(i) Breach of contract

The redraws were processed through the Origin CAP BUREAU software system. One weakness of the system, of which Pioneer was aware, was that an authorised person could direct payments to a third party account. This gap in security, however, could have been avoided by cross-referencing the electronic transaction records produced by Columbus (and its predecessor, ANZ) against Pioneer's records. Indeed, on evidence, it was found that the only way to detect frauds of $10,000 or less (the amount of Dando's fraudulent transfers) was for such manual cross-checks to be performed.

Pioneer relied on an interpretation of the software system manual that effectively allowed for frauds below $10,000 to go undetected. The Full Court dismissed this argument, holding that the "reasonably prudent mortgagee" in the contractual obligation is an objective standard (at [44]). This means, relying on a gap in the manual is insufficient to dispose of the reasonably prudential obligation to maintain risk management procedures.

Under the relevant deeds between Columbus and Pioneer, the latter was contractually obliged to "take such steps and maintain such procedures as would be taken and maintained by a 'reasonably prudent mortgagee'" (at [25]). The Full Court held that Pioneer's failure to perform these cross-checks, despite easily being able to do so, amounted to a breach of Pioneer's contractual obligation. The Full Court further held that Pioneer had failed to manage the mortgage in an "efficient and businesslike manner and in accordance with sound business practices", as stipulated by the contracts (at [33]).

(ii) Vicarious liability

The Full Court held that vicarious liability in the course of employment may arise on one of two bases: the acts of the employee may be attributed to the employer, or, alternatively the liability of the employee may be attributed to the employer.

(1) Attribution of acts

As Dando's fraudulent acts were unauthorised by her employer, the Full Court had to consider whether Pioneer could be held liable for acts it had not authorised. The Court referred to the principles of agency, where acts done under the cover of authority that a servant is held out to possess can be attributed to the employer. In this case, the Full Court found that Dando's fraudulent acts were committed in the course of doing the class of acts that Dando had been empowered to do by Pioneer, namely, managing redraw funds. As the fraud was performed in the apparent execution of the authority that Pioneer held Dando out as having, Pioneer was deemed to be vicariously liable for those acts.

(2) Attribution of liability

The Full Court noted the accepted test in England that an employee's liability may be attributed to the employer where there is sufficient connection between the employment relationship and the tort committed: *Cox v Ministry of Justice [2016] UKSC 10; [2016] 2 WLR 806, 812 [17]* (Cox).While this test has yet to be adopted by the High Court of Australia, it has been applied by intermediate and appellate courts. In this case, the Full Court held that there was a sufficiently close connection between Dando's fraudulent acts and her employment, as the fraud was perpetrated through the access and authority derived from Dando's role as a manager overseeing redraws, thus satisfying the Cox test.

The Full Court concluded that, as Pioneer could be held vicariously liable on either basis, it was unnecessary to determine the true nature of attribution (act or liability).

(iii) Breach of consumer law

The final ground of appeal concerned whether Dando's misleading or deceptive conduct was committed "on behalf of" Pioneer within the meaning of s. 84(2) of the *Trade Practices Act 1974 (Cth)* and s. 84(2) of the Competition and Consumer Act 2010 (Cth). The Full Court readily endorsed the primary judge's reasoning that an act is done "on behalf of' a corporation if the person is engaged in the conduct in the course of the corporation's business affairs or activities" (at [80]). In this case, Dando was acting in the course of Pioneer's business when she falsely represented to the funder that the customers had requested the redraws and authorised the transfer of the funds she performed.

6.9 Setting aside statutory demands under s. 459H and s. 459J of the Corporations Act 2001 (Cth)

(By Rachel Tucker, Herbert Smith Freehills)

In the matter of Access Elevators Australia Pty Ltd [2016] NSWSC 739, Supreme Court of New South Wales, Robb J, 9 June 2016

(a) Summary

The Court considered an application to have three statutory demands set aside on several grounds under Part 5.4, Division 3 of the Corporations Act 2001 (Cth) (the Corporations Act). A statutory demand is a notice served by a creditor upon a debtor for the repayment of a debt. In relation to the substantive issues, Robb J held that:

- a "genuine dispute" under s. 459H(1)(a) of the Corporations Act requires a "plausible contention requiring investigation" (at [30]);
- an "offsetting claim" under s. 459H(1)(b) of the Corporations Act must be "genuine" in that it must not "fail to establish a triable issue" (at [43-44]);
- a statutory demand signed by a single partner alone, where that partner has described themselves as a "joint creditor" on the form, will be defective such that a substantive injustice would be caused pursuant to s. 459J(1)(a) (at [95-96]); and
- a statutory demand signed by a single partner alone will also satisfy s. 459J(1)(a) where the other partner expressly refuses their authority for the other to sign on behalf of the partnership and supports the application to have the demand set aside (at [105-109]).

(b) Facts

The plaintiff, Access Elevators Australia Pty Ltd (Access), is a lift installation and servicing business. Access sought to have three statutory demands served against it by a former Managing Director, Mr Kearns, set aside.

(i) First demand

The first demand was for an unpaid loan and interest in the amount of $43,100. Access sought to have this amount reduced by $1,439.78 on the basis of s. 459H(1)(a) of the Corporations Act. Under this provision, the Court has the ability to set aside a demand where it is satisfied that "there is a genuine dispute between the company and the respondent about the existence or amount of a debt to which the demand relates".

Access also sought to have $20,776 of the first demand set aside as an offsetting claim pursuant to s. 459H(1)(b) of the Corporations Act. Access asserted that Mr

Kearns was indebted to the company in an amount of at least $20,776 for expenses wrongly claimed during his time as Managing Director.

(ii) Second demand

The second demand was sought by Mr Kearns on behalf of himself and a current company director, Mr Pirona, in the amount of $313,314. This amount was comprised of two loans, interest and unpaid rent. Access sought to have the demand set aside under s. 459J(1)(a) of the Corporations Act. This section provides that a demand may be set aside where there is a "defect" such that a "substantial injustice would be caused." Alternatively, the company argued that the Court should exercise its discretion to set aside the demand for "some other reason" under s. 459J(1)(b) of the Corporations Act.

The statutory demand was argued to be defective as it was only signed by Mr Kearns "in his capacity as joint creditor" (at [75]). Mr Pirona had also expressly refused to sign the demand and had joined in supporting Access to have it set aside. Mr Kearns sought leave to re-open the proceedings in relation to the second demand in order to tender further evidence.

(iii) Third demand

The third demand was sought by Mr Kearns for a loan and interest in the amount of $20,417. It was signed by Mr Kearns in his capacity as partner of the Kearns Enterprises partnership on behalf of himself and three company directors (Mr Pirona, Mr Hanson and Mr Okorn) (at [10]). Mr Hanson had denied consent for Mr Kearns to sign the demand on behalf of the partnership and had supported Access in its application to have it set aside. Access sought to have this set aside under s. 459J(1)(a) of the Corporations Act.

(c) Decision

(i) There was a "genuine dispute" in relation to the first demand

Robb J affirmed the test for a "genuine dispute" under s. 459H(1)(a) enunciated by McClelland CJ in *Eyota Pty Ltd v Hanave Pty Ltd (1994) 12 ACSR 785*. That is, a "genuine dispute" is a "plausible contention requiring investigation" (at [30]). Robb J found that this threshold had been met. The "company had no evidence that it was indebted to Mr Kearns" and the evidence adduced by Mr Kearns was insufficient to establish the existence of the debt (at [40]).

(ii) An "offsetting claim" was not established in relation to the first demand

Robb J considered the meaning of "offsetting claim" under s. 459H(1)(b) of the Corporations Act. His Honour found that such a claim must be "genuine" i.e. not "vexatious, frivolous or based on a mere assertion" (at [43]). It must not "fail to establish a triable issue" (at [44]). Robb J concluded that the evidence adduced by Access was insufficient to meet this test. Both the affidavit from company director Mr Hanson and an independent accountant's report suggesting that the claims were

not legitimate, were based on a series of "assertions" by the other directors as to what expenses were appropriate without proper justification (at [54] and [63]).

(iii) The second and third demands were "defective"

In determining Mr Kearns' application to reopen the proceedings in relation to the second demand, Robb J addressed whether s. 459J(1)(a) was satisfied based on the submissions and evidence at the initial proceedings. Mr Kearns argued that despite having signed the demand as a joint creditor, his relationship with Mr Pirona was a "partnership" (at [85]). As such, he could "validly execute a statutory demand on behalf of all partners [i.e. Mr Pirona]" even without their authority (at [87]). He relied on the judgment of Black J in *Re Australia Seiwa Pty Ltd* [2012] NSWSC 1334 (Seiwa) in support of this proposition (at [88]).

Robb J concluded that this argument was "fatally flawed at its inception" (at [95]). His Honour accepted that a debt owed to a partnership was "materially different" from one owed to joint creditors (at [95]). Thus, by describing himself as a joint creditor on the demand form, the debt had been "misdescribed" (at [95]). This constituted a defect in itself under the Corporations Act. Access (as recipient of the demand) would have cause to think that the demand was invalid as it was not signed by all joint creditors. It could potentially "ignore it and fail to apply have it set aside" (at [96]) in satisfaction of the "substantial injustice" requirement under s. 459J(1)(a).

In the event that this analysis was incorrect, Robb J also concluded that a statutory demand signed by only one partner where the "other had positively denied that authority" and supported it being set aside would be defective (at [106]). His Honour stated that Mr Kearns' submissions had "confuse[d] the difference between the power of one partner to sign a statutory demand in a manner that makes it valid, and the authority of a partner to do so in a manner that binds the other partners" (at [103]). He distinguished this case from Seiwa where the partner signing the statutory demand had the authority of the other. As Mr Kearns had sought to reopen the proceedings to adduce further evidence of the partnership, his application was denied. The third demand was also set aside on this basis.

(iv) The circumstances of the case provided "some other reason" that the second demand should be set aside

Robb J also concluded that the second demand could be set aside under s. 459J(1)(b) given the "relatively exceptional" circumstances in which the demand was issued (at [111]). The circumstances included (but were not limited to) the fact that Mr Pirona had expressly refused consent to sign the demand, remained a director of the company and had joined Access in its application to have the demand set aside.

6.10 AFL player manager found to have breached duties as a director

(By Tahanna Byatt, King & Wood Mallesons)

Strategic Management Australia AFL Pty Ltd v Precision Sports & Entertainment Group Pty Ltd [2016] VSC 303, Supreme Court of Victoria, Sifris J, 7 June 2016

(a) Summary

This case concerned alleged breaches of contractual, statutory and fiduciary obligations by officers of Strategic Management Australia AFL Pty Ltd (Strategic), and a claim of oppression against Strategic by one it shareholders. The Court held that:

- the officers had failed to adequately protect the income stream of Strategic and had therefore failed to act in the best interests of Strategic or exercise the required degree of care and skill expected of them; and
- a capital raising undertaken by Strategic for the main purpose of diluting one of its shareholders amounted to unfair and oppressive conduct under s. 232 of the Corporations Act 2001 (Cth) (the Corporations Act).

(b) Facts

Strategic was established by Mr Sourasis to offer sports management services to AFL players and to generate revenue through the provision of those services. Mr Sourasis had no previous experience as an agent for professional sports people and therefore enticed Mr Pickering and Mr Pitcher to become employees and officers of Strategic. Mr Pickering and Mr Pitcher were both accredited AFL player agents and had previously worked at the AFL Division of International Management Group.

To entice Mr Pickering to join Strategic, Mr Sourasis made a number of promises to him, which included Chillimia Pty Ltd (Chillimia), a company owned by Mr Pickering, being granted 50% of the shares in Strategic.

Mr Pitcher commenced at Strategic in April 2011, while Mr Pickering commenced later in September 2012. Due to certain issues between Mr Sourasis and Mr Pickering and Mr Pitcher, Mr Pickering's formal appointment as Managing Director of Strategic did not occur until much later and Chillimia was not issued any shares in Strategic until August 2013.

In connection with the ongoing issues between the parties, from 31 October 2011 to 4 November 2014 Mr Sourasis loaned significant sums of money from Strategic's accounts (some of which was repaid).

In April 2014, Mr Pickering and Mr Pitcher incorporated Precision Sports & Entertainment Group Pty Ltd (Precision) with the intention of it operating a new

competing sports management business, and considered which players Strategic represented they would seek to "move across" to Precision.

Mr Pickering and Mr Pitcher resigned from Strategic on 1 May 2014. In October 2014 Strategic undertook a capital raising, allegedly to raise funds for litigation against Mr Pickering and Mr Pitcher. The capital raising diluted Chillimia's shareholding in Strategic and formed the basis of Chillimia's grounds for oppression.

In the proceedings Strategic alleged that:

- Mr Pickering and Mr Pitcher breached their contractual duties to Strategic by failing to recruit players as Strategic clients;
- both agents breached their fiduciary duties to Strategic by failing to act in Strategic's best interests or with the required degree of care and skill expected of them; and
- both agents breached their duties as officers of Strategic under the Corporations Act.

(c) Decision

The Court found that Mr Pickering and Mr Pitcher had breached their duties as officers of Strategic and that Strategic had suffered loss and damage as a result. The Court also found that the capital raising by Strategic constituted oppression as its main purpose was to dilute the shareholding of Chillimia.

(i) By virtue of their employment relationships with Strategic, were both agents in breach of their contractual duties?

His Honour found both agents were in breach of their employment agreements with Strategic by failing to recruit and retain AFL players as clients of Strategic and safeguard Strategic's interests. His Honour held that it was the responsibility of both agents to protect the revenue of Strategic by ensuring fees were generated from player contracts for the life of the contract. The fact that many contracts with players expired a short time after they were executed, and neither Mr Pickering nor Mr Pitcher (as experienced, accredited AFL agents) attempted to extend those contracts, meant Strategic was not protected. It was immaterial that players may not have extended their contracts with Strategic, as the failure of both agents to attempt to re-sign players was sufficient to breach their contractual obligations with Strategic.

(ii) Contraventions of ss. 180-183 of the Corporations Act

The assessment of whether both agents had failed to discharge their duties as officers of Strategic with the required degree of care and skill was dependent upon Strategic's business operations and the agents' specific roles with Strategic. His Honour held that the failure of both agents to protect the source of Strategic's income amounted to a breach of s. 180(1) of Corporations Act. Accordingly, his

Honour found it must therefore follow that both agents also failed to act in good faith and in the interests of Strategic pursuant to s. 181(1) of the Corporations Act.

Although both agents gained some advantage from their respective positions with Strategic, it was held they did not use their positions solely to advantage themselves or to cause detriment to Strategic, and were therefore not in breach of ss. 182(1) or 183(1) of the Corporations Act.

(iii) Was the increase of share capital grounds for oppression?

His Honour was satisfied that Strategic's capital raising which diluted Chillimia's interest was oppressive, as this was its dominant purpose. His Honour noted, that although the capital raising in itself was sufficient grounds to make a finding of oppression, Strategic's poorly kept company records and books, as well as Mr Sourasis' loaning money from Strategic's accounts, would also have amounted to unfair and thus oppressive conduct in the circumstances.

6.11 Wine in a can: application to bring statutory derivative action granted

(By Elly Phelan, MinterEllison)

Daiwa Can Company v Barokes Pty Ltd [2016] VSC 296, Supreme Court of Victoria, Sifris J, 7 June 2016

(a) Summary

This case is concerned with an application for leave brought by minority shareholders to bring (or continue) a proceeding in the name of Barokes Pty Ltd (Barokes), against Barokes' majority shareholder, Daiwa Can Company (Daiwa).

After considering substantial evidence, Sifris J granted leave (*nunc pro tunc*) in accordance with s. 237 of the Corporations Act 2001 (Cth) (the Corporations Act) .

(b) Facts

Barokes is an Australian company based in Melbourne which manufactures wine in cans. The plaintiffs were shareholders in Barokes, holding 26.7% (Knights Quest) and 13.3% (SMS Management) respectively. Daiwa, a manufacturer of aluminium cans, held the remaining 60%. Knights Quest is controlled by Mr Stokes and SMS Management is controlled by Mr Barics.

Barokes, Daiwa, Knights Quest and SMS Management entered into a shareholders deed, which entitled Daiwa and Knights Quest to appoint 2 directors each to the board of Barokes. Since then, the board of Barokes has been made up of:

- Mr Yoshitaka Ikeda and Mr Tetsuo Yamashita, as appointees of Daiwa; and
- Mr Stokes and Mr Barics as appointees of Knights Quest.

Barokes holds or is the applicant for patents referred to as Vinsafe, Ressafe and Resvin in up to 30 countries, including Japanese patent JP3668240 (the Japanese patent).

The dispute the subject of the application derives from Daiwa's supply of cans to Monde Shuzo Ltd (Monde), a Japanese subsidiary of Daiwa, for use in canning wine. As a result of this, Mr Stokes attempted to pass board resolutions authorising him to conduct litigation on behalf of Barokes to sue Monde (and a number of other companies) for patent infringement. Mr Yoshitaka Ikeda and Mr Tetsuo Yamashita opposed Mr Stokes' resolutions. Despite this, Mr Stokes caused Barokes to commence proceedings against Daiwa, Monde and other companies in Japan for infringement of patent relating to various wine products, claiming damages of approximately AUD $1 million (Japanese proceeding).

Around this time, the plaintiffs commenced oppression proceedings again Daiwa in the Victorian Supreme Court and Daiwa filed an application to wind up Barokes on the just and equitable ground (the Victorian proceedings).

(i) Law

The plaintiffs' application for leave was brought pursuant to s. 237 of the Corporations Act which provides that:

- (1) a person referred to in paragraph 236(1)(a) may apply to the Court for leave to bring, or to intervene in, proceedings; and
- (2) the Court must grant the application if it is satisfied that:
  - it is probable that the company will not itself bring the proceedings, or properly take responsibility for them, or for the steps in them;
  - the applicant is acting in good faith;
  - it is in the best interests of the company that the applicant be granted leave;
  - if the applicant is applying for leave to bring proceedings-there is a serious question to be tried;
  - either:
    - at least 14 days before making the application, the applicant gave written notice to the company of the intention to apply for leave and of the reasons for applying; or
    - it is appropriate to grant leave even though subparagraph (i) is not satisfied.

Daiwa opposed the application on the grounds that the plaintiffs were not acting in good faith, that it was not in the best interests of Barokes for leave to be granted, and there was no serious question to be tried.

To determine whether the application had been brought in good faith, Sifris J considered the judgment of Palmer J in *Swansson v R A Pratt Properties Pty Ltd & Anor* [2002] NSWSC 583 (Swansson). In Swansson, Palmer J identified two factors to have regard to in determining whether the good faith requirement is satisfied. The first is whether the applicant honestly believes that a good cause of action exists and has a reasonable prospect of success and the second factor is whether the applicant is seeking to bring the derivative suit for such a collateral purpose as would amount to an abuse of process.

Mr Stokes, on behalf of the plaintiffs, deposed to an honest belief that a good cause of action existed in the Japanese proceeding that had a reasonable prospect of success, relying on advice from lawyers, patent attorneys and various other experts.

Daiwa disputed that there was a patent infringement and also asserted that Mr Stokes had previously made representations regarding the Japanese patent that were inconsistent with the arguments advanced in the Japanese proceeding. Daiwa submitted further that the Japanese proceeding had been issued for the collateral purpose of placing pressure on Daiwa to come to a settlement regarding the Victorian proceedings.

In relation to the best interests of Barokes, the plaintiffs contended that as they were providing an indemnity in relation to the costs that would be associated with the Japanese proceeding, the consideration of the best interests of the company is in favour of the plaintiffs. It was submitted that if there is a serious question to be tried and costs are indemnified then the balance is in favour of granting the application. Further, the plaintiffs submitted that Mr Ikeda would never authorise a suit against the companies of which he is also a director, Daiwa or Monde. As a result, it was contended that Mr Ikeda could not have regard to Barokes' interests to the extent that they differ from the interests of Daiwa and Monde.

Daiwa submitted that the plaintiffs' application derived from an internal dispute between shareholders of Barokes and that accordingly, the best interests of the company would be for Barokes to focus on increasing sales of its product instead of pursuing a hopeless action. Daiwa submitted that in circumstances where the shareholders and the board are deadlocked, it is not in the interests of the company for leave to be given to commence a proceeding by one side against the other.

In relation to whether there was a serious question to be tried the plaintiffs referred to the evidence relied upon by Mr Stokes to form his honest belief. Daiwa on the other hand, submitted that the Japanese patent will be found to be invalid because of a lack of an inventive step given certain prior art, in contrast to the expert evidence relied upon by Mr Stokes.

(c) Decision

Sifris J was satisfied that Mr Stokes' belief in relation to the Japanese proceeding was reasonable as it was based upon advice from various other experts, holding that good faith had been demonstrated and the Japanese proceeding was not issued for a collateral purpose.

Sifris J was also satisfied that the Japanese proceeding was in the best interests of Barokes as a separate and independent entity because it had a serious case, would not be liable for the costs and stood to benefit from a substantial award in its favour.

Sifris J was also satisfied that there was a serious question to be tried.

It was also noted that the authorities recognise that one way of resolving a deadlock between shareholders or a board, is to use the procedure provided in the Corporations Act and that this is the preferable way in cases where the claim in the name of the company against a shareholder is the very reason for the deadlock.

Sifris J granted the leave sought by the plaintiffs, subject to the plaintiffs providing an undertaking to indemnify and hold Barokes harmless against all or any costs that may be incurred in relation to the Japanese proceeding.

6.12 Section 203D(1) of the Corporations Act: Not the only way to remove directors of a public company

(By Ivan Biros and Annabel Doneley, Clayton Utz)

State Street Australia Ltd v Retirement Villages Group Management Pty Ltd [2016] FCA 675, Federal Court of Australia, Beach J, 7 June 2016

(a) Summary

In this case, the Federal Court of Australia determined that, although s. 203D(1) of the Corporations Act 2001 (Cth) (the Corporations Act) will override a company's constitution to the extent of any inconsistency, it does not provide an exhaustive codification of the mechanism for removal of a director of a public company.

(b) Facts

State Street Australia Ltd in its capacity as custodian for Retail Employees Superannuation Pty Ltd as trustee of the Retail Employees Superannuation Trust, and Retail Employees Superannuation Pty Ltd as trustee of Retail Employees Superannuation Trust (REST) are the only remaining external investors in the Retirement Villages Group (RVG), holding approximately 27% of its stapled

securities. Aveo Group Ltd and its subsidiary Retirement Villages Group Management Pty Ltd (RVGM) hold the balance of the stapled securities in RVG.

RVG consists of three stapled entities: Retirement Villages Australia Ltd (RVAL), Retirement Villages Trust (the responsible entity of which is Retirement Village Group RE Ltd) and RVNZ Investments Ltd.

RVGM issued two separate notices seeking to convene a general meeting of the RVAL securityholders in which it proposed resolutions for the removal of two independent directors.

The RVAL Constitution requires RVAL to have five directors with three of those directors being independent directors appointed under clause 11.6 of the RVAL Constitution. Clause 11.6 of the RVAL Constitution provides that independent directors are to be nominated and approved by the external investors of RVAL (i.e. REST).

The first explanatory notice issued by RVGM referred to provisions for the removal of the directors under both s. 203D of the Corporations Act and the RVAL Constitution. The second notice sought to have the resolutions put to the RVAL securityholders only under the provisions for removal of directors contained in the RVAL Constitution. RVGM and RVAL did not expressly invoke s. 203D(1) of the Corporations Act as a mechanism for removing directors in the second notice.

The key issue in dispute between the parties in this case was whether the provisions of s. 203D(1) of the Corporations Act provided an exhaustive codification or, alternatively, an additional method to that available under the company's constitution, to remove a director.

REST relied on the decision of Bryson AJ in *Scottish & Colonial Ltd v Australian Power and Gas Co Ltd* [2007] NSWSC 1266 to assert that the provisions of s. 203D(1) of the Corporations Act provide the only mechanism by which a director of a public company can be forcibly removed to the exclusion of any mechanism in a company's constitution.

Section 203D(1) of the Corporations Act provides that:

"A public company may by resolution remove a director from office despite anything in:

- (a) the company's constitution (if any); or
- (b) an agreement between the company and the director; or
- (c) an agreement between any or all members of the company and the director.

If the director was appointed to represent the interests of particular shareholders or debenture holders, the resolution to remove the director does not take effect until a replacement to represent their interests has been appointed."

(c) Decision

Beach J determined that although s. 203D(1) of the Corporations Act is mandatory in the sense that it overrides a company's constitution to the extent of any inconsistency, it does not provide an exhaustive codification of the mechanism for removal of a director. In reaching this conclusion, Beach J considered the language and context of s. 203D(1) of the Corporations Act and noted that:

- the use of the words "[a] public company may." rather than the words "may only." suggests that s. 203D(1) of the Corporations Act provides a mechanism, rather than the mechanism;
- the words "despite anything in..the company's constitution" clearly indicates that s. 203D(1) of the Corporations Act operates to override any mechanism contained in a company's constitution only to the extent of any inconsistency;
- nothing turns on the fact that s. 203D of the Corporations Act is not a replaceable rule. It is there as a default mechanism rather than the mechanism; and
- there was nothing to be read from the fact that s. 203D of the Corporations Act does not contain a subsection that states "the section does not derogate from any power to remove a director that may exist apart from the section," as was present in its predecessor provision (s. 227(11) of the Corporations Law).

Beach J found that s. 203D did not operate to oust the director removal mechanism in the RVAL Constitution as the Constitution was not inconsistent with the provisions of s. 203D of the Corporations Act.

REST contended in the alternative that even if the mechanism under the RVAL Constitution had not been displaced, that the rider in s. 203D(1) of the Corporations Act is separately mandatory and operates so as to defer the effect of the resolutions once passed under the mechanism of the RVAL Constitution until replacement directors of RVAL have been appointed. Section 203D(1) contains a rider which provides:

"If the director was appointed to represent the interests of particular shareholders or debenture holders, the resolution to remove the director does not take effect until a replacement to represent their interests has been appointed."

Beach J rejected this argument on the basis that the rider in s. 203D(1) could not be relied upon separately to the operative part of the section. The rider did not apply in the circumstances as the operative provisions of s. 203D(1) had not been invoked, due to the mechanism under the RVAL Constitution being used for the removal of the directors.

6.13 An unfair preference may also be an uncommercial transactions in certain circumstances

(By Grant Mason & Agnieszka Deegan, Corrs Chambers Westgarth)

Ashala Model Agency Pty Ltd (in liquidation) v Featherstone [2016] QSC 121, Supreme Court of Queensland, Jackson J, 6 June 2016

(a) Summary

The Court held that a transaction which had the effect of transferring substantially all of the assets of a company to one of its creditors (who was also a de facto director and the sole shareholder of the company) also constituted an uncommercial transaction and a transaction by which the company had intended to defeat the interests of other creditors. The Court granted relief requiring that creditor to return the asset to the company for the benefit of the creditors generally because it was obtained under a transaction that was voidable pursuant to s. 588FE(5) of the Corporations Act 2001 (Cth) (the Corporations Act).

(b) Facts

The first plaintiff, Ashala Model Agency Pty Ltd (in liquidation) (Ashala) was incorporated on 24 May 2005. At all material times, the first defendant, Mr Darrell Morgan Featherstone (Mr Featherstone) was a de facto director and the sole shareholder of Ashala.

Shortly after incorporation, Ashala entered into a three-year lease agreement of a property at Alfred Street in North Brisbane by which it leased that property from Mr Featherstone. Although according to the lease, the yearly rent of $166,050 was payable in advance, the contract was varied so that the rent was only payable on demand by Mr Featherstone. By 1 July 2007, Ashala had paid no rent for three years and its liability to Mr Featherstone under the lease was $498,150.

Sometime in July 2007, Mr Featherstone became interested in purchasing a unit in Quay West apartments in Alice Street, Brisbane for $460,000 (the Unit). On 1 August 2007, Ashala paid $23,000 to or on behalf of Mr Featherstone, being a 5% deposit for the purchase of the Unit (the Deposit).

At the time of the payment of the Deposit, Ashala's bank accounts held surplus funds from trading. However, Ashala had not paid any of the rent due to be paid by it, it had not complied with any of its tax reporting obligations and it had not paid any tax during that period.

On 4 August 2007, Ashala and Mr Featherstone executed a document under which they agreed Mr Featherstone to accept $460,000 as "full and final" payment by

Ashala of all rent owing for the period up to 30 June 2008 (the August Agreement). On 16 August 2007, a cash cheque in the amount of $453,010 was debited from one of Ashala's accounts.

On 21 August 2007, the Unit was purchased using the $435,010 in funds withdrawn from Ashala's account. Thereafter, Mr Featherstone lived in the Unit and subsequently became the registered owner on 28 April 2011.

Following the payments made on 1 and 16 August 2007 (the Challenged Payments), Ashala's trading slowed dramatically and ceased entirely by the end of the year. On 12 October 2008, Ashala was deregistered by ASIC.

On 24 July 2012 Ashala was reinstated by order of the court and the second plaintiff, David James Hambleton (Liquidator), was appointed as liquidator of the Ashala. The Liquidator formed the view that the purchase of the Unit (a transaction to which Ashala was a party by reason of the Challenged Payments) was a voidable transaction under s. 588FE(5) of the Corporations Act. That subsection provides that a transaction is a voidable transaction where: first, the transaction is an "insolvent transaction", secondly, the company became a party to the transaction for purposes including the purpose of defeating, delaying or interfering with the rights of any. of its creditors in a winding up" and the transaction occurred within ten years of the "relation-back day".

Accordingly, the Liquidator applied to the Court for an order under s. 588FF(1)(d) of the Corporations Act that Mr Featherstone be required to transfer the Unit to Ashala. Under that section, such an order can be made in circumstances where a court is satisfied that the transaction is voidable under s. 588FE.

(c) Decision

The Court found that Ashala was a party to the transaction by which the Unit was purchased by reason of the Challenged Payments that it had made under the August Agreement.

The Court considered the circumstances of Ashala at the time of the Challenged Payments. Following those payments, Ashala was not in a position to meet its unpaid tax liabilities, whatever they might have been and therefore either was insolvent at the time of those payments or became insolvent as a result of those payments. The Court therefore concluded that Ashala was insolvent around that time and that the Challenged Payments were an insolvent transaction of Ashala within the meaning of s. 588FC of the Corporations Act.

As to the question of whether or not Ashala was actually insolvent at the time of the Challenged Payments, Mr Featherstone contended that Ashala was solvent because it could have relied on him to provide funds to meet its liabilities. The Court noted that, tellingly, he did not ultimately do so and Ashala (of which Mr Featherstone was the controlling mind and will) could not have had a reasonable

expectation that Mr Featherstone would consider himself bound to provide funds to it in order to allow it to remain solvent.

Next the Court looked at the August Agreement and determined that the effect of that Agreement was that Mr Featherstone received payment in respect of substantially all of the liability owed to him by Ashala, in respect of the property rented by Ashala from him. That left him in a better position than he would have been if Ashala was wound up and he was required to prove for his debt on equal terms with other creditors of the company. The Challenged Payments therefore amounted to an unfair preference within the meaning of s. 588FA of the Corporations Act.

Further, Mr Featherstone, as the controlling mind and will of Ashala, must have known that the effect of the Challenged Payments would have been to leave Ashala in a position where it was unable to meet its liabilities to other creditors, such as the Australian Taxation Office (ATO). It could therefore be inferred that the intention of the Challenged Payments was to deprive the ATO and other creditors of moneys that would be owed to them by Ashala. In that regard, the Challenged Payments were a voidable transaction within the meaning of s. 588FE of the Corporations Act.

Although not strictly necessary for the relief claimed, the Court held that having regard to the situation that Ashala would find itself in after the Challenged Payments, the transaction was also an uncommercial transaction within the meaning of s. 588FB of the Corporations Act. The Court pointed out that a voidable unfair preference would not necessarily amount to an uncommercial transaction. However, in this instance the effect of that transaction was to leave Ashala in a situation where it could not continue to trade.

Accordingly, the Court ordered Mr Featherstone to transfer the Unit back to the Company so that that asset could be used to satisfy Ashala's liabilities to its creditors on equal terms. As one of those creditors, Mr Featherstone would still be entitled to prove in the liquidation of Ashala for the amount of the debt owed to him.

6.14 English Court confirms that UK-domiciled entities may face proceedings in the UK for torts committed by their subsidiaries overseas

(By Dominic Landvogt, King & Wood Mallesons)

Lungowe v Vedanta Resources Plc and Konkola Copper Mines Plc [2016] EWHC 975 (TCC), England and Wales High Court (Technology and Construction Court), Coulson J, 27 May 2016

(a) Summary

This case concerned an action brought principally in negligence by some 1,826 Zambian villagers against Konkola Copper Mines plc (KCM), a Zambian-domiciled company which owned and operated a major copper mine in that country, and its UK-domiciled holding company, Vedanta Resources Plc (Vedanta). The underlying claims related to alleged pollution caused by the mine to the local water supply, resulting in loss and personal injury suffered by the claimants. It was alleged that both the English parent and Zambian subsidiary owed, and breached, a duty of care to the Zambian residents.

Both KCM and Vedanta challenged the jurisdiction of the English High Court to hear the claims against them, on the basis that Zambia was the appropriate place for the claims to be heard. However, Coulson J of the High Court rejected both defendants' challenges.

This decision brings together two separate, settled strands of English and European law:

- the first strand, grounded in European regulation and a decision of the European Court of Justice (ECJ), provides that an English court may not stay a claim against an English-domiciled company on the grounds of *forum non conveniens*; and
- the second strand provides that a parent company may owe a duty of care to the employees of a subsidiary, and potentially to other persons interacting with that subsidiary.

The result is that English-headquartered parent companies, which operate overseas via foreign-domiciled operational subsidiaries, may struggle to challenge English courts' jurisdiction, even where the underlying claim arises entirely from the negligent acts of the foreign subsidiary. This will clearly have significant impacts for global, English-headquartered corporations. However, given the centrality of ECJ law to this decision, that impact may be mitigated by the UK's likely exit from the EU in the near future.

(b) Facts

Vedanta acquired its interest in KCM in 2004 through an intermediary holding company. It held 79.42% of the shares in KCM, with the remainder held by the Zambian state. The claimants alleged that from 2005 onwards KCM's mining operations discharged harmful effluent into local waterways on numerous occasions.

In almost all material respects, the logical forum for the claims was Zambia. The applicable law was Zambian law, and the commission of the alleged tort (i.e. the discharge of the relevant chemicals into waterways) occurred in Zambia. Further, the claimants were all Zambian citizens and residents, and all relevant personal

injuries and damage to land was suffered in Zambia. Logistical difficulties also rendered Zambia the more logical place for the trial.

However, there was evidence that KCM was experiencing significant financial difficulties and may be unable to respond to a judgment against it. Vedanta, on the other hand, was a well-resourced defendant. The claimants also expressed concerns that justice would not be served adequately, or promptly, by pursuing KCM in the Zambian courts.

Accordingly, claims were lodged in the UK against KCM and Vedanta. The claimants alleged that the UK-domiciled Vedanta had assumed a duty of care towards them. That duty was said to arise "as a result of their assumption of responsibility for ensuring that [KCM]'s mining operations do not cause harm to the environment or local communities, as evidenced by the very high level of control and direction that [Vedanta] exercise at all material times over the mining operations of [KCM] and its compliance with applicable health, safety and environmental standards."

The defendants applied for a stay of proceedings, on the basis that the United Kingdom was not the appropriate jurisdiction to try the claims.

(c) Decision

(i) Vedanta's application for a stay in proceedings

The *forum non conveniens* principle has historically permitted an English court to decline jurisdiction by granting a stay of proceedings where a court in another forum has competent jurisdiction and is a clearly more suitable forum to try the case. However, Article 4 of the *Brussels Regulation* mandates that: "Subject to the provisions of this Convention, persons domiciled in a Contracting State [i.e. a member of the EU] shall, whatever their nationality, be sued in the courts of that State".

In 2005, the ECJ decision in *Owusu v Jackson [2005] QB 801* (Owusu) confirmed that the English courts do not have jurisdiction to stay proceedings against a defendant domiciled in the UK in favour of a court of a non-Contracting State.

The claimants therefore submitted that Owusu made it clear that the *Brussels Regulation* entitled them to sue Vedanta in the United Kingdom, and that the Court retained no residual discretion to refuse jurisdiction on the ground that Zambia was a more suitable forum. Any such discretion would undermine the predictability of the rules of jurisdiction set out in the *Brussels Regulation*.

Coulson J noted that the reasoning in Owusu was capable of sustained criticism. In particular, in Owusu the ECJ had emphasised the need for defendants to have certainty about the forum in which they may be sued, whereas the doctrine of *forum non conveniens* is inevitably invoked by a defendant who wishes to avoid being sued in English courts. However, Coulson J noted that both the binding nature of the ECJ's decision in Owusu, and the weight of subsequent UK authority

supporting the decision, prevented any application of the *forum non conveniens* principle.

Vedanta further submitted that the proceedings should be stayed on the basis that they were an abuse of EU law. Coulson J held that it was unable to meet the "high hurdle" necessary to prove such abuse. In particular, the claimants were not pursuing Vedanta for the "sole reason" of obtaining access to the English courts and ousting the jurisdiction of another court. Rather, there was evidence that KCM may not have the financial means to respond to a judgment in Zambia. More importantly, there was significant evidence that Vedanta was in fact the "real architects" of the environmental pollution, given its material interest in KCM's mining activity.

Coulson J also rejected Vedanta's application for a stay on effective case management grounds. Coulson J noted that the Court retains the power to grant a stay on such grounds despite the Owusu decision, as it should remain the master of its own process and procedure. However, given there was a real issue to be decided between the parties, he concluded that it would be inappropriate to exercise such a power.

(ii) KCM's application for a stay in proceedings

KCM also applied for a stay of proceedings on *forum non conveniens* grounds. As KCM was domiciled in Zambia, the *Brussels Regulation* did not apply, and KCM accordingly submitted that the order permitting service on KCM outside of the UK should be set aside.

The claimants submitted that it would be appropriate for the claims against KCM to also be heard in the UK, in parallel with the Vedanta proceedings. Further, the claimants submitted that they would not obtain justice in Zambia. In contrast, KCM submitted that, as outlined above, all of the relevant facts had occurred in Zambia, and that the claim against Vedanta was an artifice to bring the KCM claim before the UK courts.

Ultimately, the Court rejected KCM's application. The relevant court rules permitted service out upon KCM where it could be shown that: (i) there was a real issue between the claimants and Vedanta which it was reasonable for the Court to try; and (ii) KCM was a "necessary or proper party" to that claim. As a preliminary step, the Court considered whether the claimants' claim against KCM had a real prospect of success (such that service out was justified under the relevant court rules).

The Court concluded that each limb was satisfied. Critically, while Coulson J was reluctant to turn the judgment into a mini trial of Vedanta's liability, he found that there was a "real issue to be tried" against Vedanta. Recent, persuasive case law had concluded that a parent company may owe a duty of care to its subsidiary's employees, provided that certain criteria were met. While a claim against a parent

company would be more successful if advanced by the subsidiary's employees, a claim by the Zambian claimants was at least arguable.

The Court concluded that, in the absence of any claim against Vedanta, it would not have been appropriate for the claim against KCM to be heard before the UK courts: the fundamental focus of the litigation was Zambia. However, the "necessary and proper party" test was satisfied, such that KCM could be served in the Vedanta matter, and the proper place for the Vedanta matter to be heard was the UK. Accordingly, to avoid parallel trials in different jurisdictions, the claims against KCM should also be heard in the UK.

This reasoning made it unnecessary for Coulson J to decide that Zambia was an inappropriate forum due to the claimants' access to justice concerns. However, his Honour did note, in obiter, that such concerns were not unfounded.

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7. Contributions

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