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From: SAI Global Information Services <corporatelawbulletin@saiglobal.com>
Sent: Wednesday, February 26, 2020 3:37 PM
To: Ian Ramsay
Subject: SAI Global Corporate Law Bulletin No. 270

26 February 2020 > Regulatory Newsfeed

SAI Global Corporate Law Bulletin No. 270>

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Bulletin No. 270

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Published by SAI Global on behalf of Centre for Corporate Law, Faculty of Law, The University of Melbourne with the support of the Australian Securities and Investments Commission, the Australian Securities Exchange and the leading law firms: Ashurst, Clayton Utz, Corrs Chambers Westgarth, DLA Piper, Herbert Smith Freehills, King & Wood Mallesons, Minter Ellison.

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Detailed Contents

1. Recent Corporate Law and Corporate Governance Developments

1.1 Report finds US class action settlements tallied US$3.17 billion in 2019

18 February 2020 - There were 101 monetary settlements of class action suits filed in the United States (US) valued at US$3.17 billion during 2019, according to a new report released by Securities Class Action Services LLC, a subsidiary of Institutional Shareholder Services.

The two largest settlements from 2019 were Cobalt International Energy which settled for US$389.6 million and Alibaba Group Holding which settled for US$250 million. Both settlements were large enough to qualify for the list of the top 100 largest US class action settlements approved since the passage of the *Private Securities Litigation Reform Act 1995 (US)*.

The 2019 total represents a significant decrease compared with 2018 when US securities class actions reached US$5.84 billion in value from 126 approved monetary settlements. One action in 2018, the US$3 billion settlement in the Petrobas matter, accounted for much of the disparity between the two years.

Cobalt was charged with violations of the Employment of Manipulative and Deceptive Practices rule (rl. 10b-5) and the Civil Liabilities on Account of False Registration Statement (s. 11 of the *Securities Act 1933 (US)* (the Securities Act)). Alibaba was charged with violating rl. 10b-5 of the Securities Act which stemmed from misstatements made during the company's initial public offering.

Eight large capital companies listed on the S&P 500 index settled cases in 2019 for a total of US$439.1 million.

A total of 74 Federal Court settlements were linked to violations of rl. 10b-5, three of which stemmed from alleged insider trading, while another three were a by-product of corporate transactions. Additionally, six federal settlements were made in connection with allegations of violations of Generally Accepted Accounting Principles (GAAP).

Another 17 settlements were tied to violations associated with the Civil Liabilities on Account of False Registration Statement (s. 11 of the Securities Act), of which 13 related to stock offerings completed by the relevant companies. Four companies that settled in Federal Court were required to restate their financials and were part of the six settlements that alleged violations of GAAP.

1.2 IOSCO publishes key considerations for regulating crypto-asset trading platforms

12 February 2020 - The Board of the International Organization of Securities Commissions (IOSCO) has published a report that describes the issues and risks associated with crypto-asset trading platforms (CTPs) and sets out key considerations to assist regulatory authorities in addressing these issues.

The development of crypto-assets is an important area of interest for regulatory authorities around the world and has been identified in the IOSCO work program as an ongoing Board priority in 2020. The report, titled Issues, Risks and Regulatory Considerations Relating to Crypto-Asset Trading Platforms, describes the issues that IOSCO has identified regarding CTPs. The report sets out key considerations intended to assist regulatory authorities in evaluating CTPs within the context of their regulatory frameworks.

The key considerations relate to:

- access to CTPs;
- safekeeping of participant assets, including custody arrangements;
- identification and management of conflicts of interest;
- transparency of operations;
- market integrity, including the rules governing trading on the CTP, and how those rules are monitored and enforced;
- price discovery mechanisms; and
- technology, including resiliency and cybersecurity.

Many of the issues related to the regulation of CTPs are common to traditional securities trading venues but may be heightened by the business models used by CTPs. Where a regulatory authority has determined that a crypto-asset is a security and falls within its remit, the basic principles or objectives of securities regulation should apply. Accordingly, the report states that the IOSCO Principles and Methodology provide useful guidance for regulatory authorities considering the identified issues and risks.

1.3 Legislation responding to recommendations of the ASIC Enforcement Review Taskforce Report and the Financial Services Royal Commission Report passed by Parliament

6 February - Two Bills responding to recommendations of the Australian Securities and Investments Commission (ASIC) Enforcement Review Taskforce Report and the Financial Services Royal Commission (the FSRC) Report were passed by Parliament on 6 February 2020.

The Financial Sector Reform (Hayne Royal Commission Response - Stronger Regulators (2019 Measures)) Bill 2019 (Cth) amends the legislation listed below. The Bill was introduced into the

House of Representatives and received its second reading speech on 28 November 2019. According to the explanatory memorandum, the Bill amends various legislation to implement recommendations from the ASIC Enforcement Review Taskforce Report to:

- harmonise ASIC's search warrant powers;
- improve ASIC's ability to access certain telecommunications information;
- strengthen ASIC's licensing powers; and
- extend ASIC's banning powers to ban individuals from managing financial services businesses.

This affects the following legislation:

- Australian Securities and Investments Commission Act 2001 No. 51 (Cth) (the ASIC Act);
- Corporations Act 2001 No. 50 (Cth) (the Corporations Act);
- National Consumer Credit Protection (Transitional and Consequential Provisions) Act 2009 No. 135 (Cth) (the NCCP(TCP) Act);
- National Consumer Credit Protection Act 2009 No. 134 (Cth) (the NCCP Act);
- Retirement Savings Accounts Act 1997 No. 61 (Cth);
- Superannuation Industry (Supervision) Act 1993 No. 78 (Cth); and
- Telecommunications (Interception and Access) Act 1979 No. 114 (Cth).

The Financial Sector Reform (Hayne Royal Commission Response - Protecting Consumers (2019 Measures)) Bill 2019 (Cth) amends the legislation listed below. The Bill was introduced into the House of Representatives and received its second reading speech on 28 November 2019. According to the explanatory memorandum, the Bill:

- implements recommendations by the FSRC in the *Final Report of the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry*, including to extend the existing protections of the unfair contract terms regime under the ASIC Act; and
- amends the NCCP Act to require mortgage brokers to act in the best interests of consumers and address conflicted remuneration for mortgage brokers.

The Bill also makes amendments to the following legislation:

- Corporations Act;
- Insurance Contracts Act 1984 No. 80 (Cth); and
- NCCP(TCP) Act.

1.4 Report reveals "slow progress" on ethnic diversity of FTSE boards

5 February 2020 - A new report published by Sir John Parker, EY and the United Kingdom (UK) Department of Business, Energy & Industrial Strategy, shows that 37% of Financial Times Stock Exchange (FTSE) 100 companies surveyed (31 out of 83 companies) do not have any ethnic minority representation on their boards.

The 2020 report provides an update from the Parker Review Committee, chaired by Sir John Parker, which was commissioned to consult on the ethnic diversity of UK boards. In its first report, published in 2017, the Parker Review made a series of recommendations and set a target for all FTSE 100 boards to have at least one director from an ethnic minority background by 2021.

However, according to the Parker Review report, which due to General Data Protection Regulation restrictions since the first report is based on voluntary data submissions, the pace of progress has been slower than hoped.

In 2017, over 50% of FTSE 100 boards (51 out of 100 companies analysed) had no ethnic representation on their boards. This compares to 37% of FTSE 100 boards in 2020 (31 out of 83 companies surveyed). The latest data reveals that, since the 2017 Review, 11 additional FTSE 100 companies now have an ethnic minority director on their board.

In addition, the 2020 Parker Review provides first time analysis of FTSE 250 boards which were found to be even less diverse than the FTSE 100. 69% of the FTSE 250 companies analysed (119 out of 173 companies) have no ethnic diversity on their boards. Across the FTSE 350, 59% have no ethnic representation on their company boards (150 out of 256 companies analysed).

To help accelerate the rate of progress, the 2020 Parker Review report sets out additional recommendations, whilst maintaining those set out in the 2017 report. The new recommendations focus on measuring board level diversity and helping to build a pipeline of board-ready candidates.

1. **Engage -** FTSE 350 companies must engage constructively on this issue and report on the ethnic diversity of their boards. The Parker Review found that a small number of companies did not respond to their request for data;
2. **Report -** The Parker Review urges companies to report fully on their ethnic diversity policies and activities as part of their reporting requirements and in compliance with the UK Corporate Governance Code;
3. **Recruit -** Executive recruiters should be much more proactive in "marketing" highly talented ethnic minority candidates and in applying their voluntary code of conduct; and
4. **Develop -** A pool of high potential, ethnic minority leaders and senior managers should be developed as part of a cross-sector sponsorship/mentoring programme. These individuals should be sponsored by chief executive officers across the FTSE 350 through a well-structured and facilitated scheme.

The report also contains a toolkit for companies and those responsible for recruitment, to help implement many of the recommendations.

View:

- Ethic Diversity Enriching Business Leadership - An update report from the 2020 Parker Review.

1.5 Draft legislation to implement recommendations of the Financial Services Royal Commission

31 January 2020 - The Australian Treasury has published draft legislation (available from the links listed below), which proposes to implement various recommendations of the Royal

Commission into Misconduct in the Banking, Superannuation and Financial Services Industry) (the Royal Commission):

- Recommendations 1.6, 2.7, 2.8, 2.9 and 7.2 - Strengthening breach reporting, which includes proposals to:
  - "strengthen breach reporting requirements for Australian financial services licensees";
  - "establish a compulsory scheme for checking references for prospective financial advisers";
  - "require Australian financial services licensees to investigate misconduct by financial advisers and appropriately remediate clients affected by the misconduct"; and
  - "introduce breach reporting requirements for Australian credit licensees more generally";
- Recommendation 1.15 - Enforceability of financial services industry codes, which includes a proposal to "allow the [ASIC] to designate enforceable code provisions which, if breached, may attract civil penalties, and to create a new mandatory code of conduct framework";
- Recommendations 2.1 and 2.2 - Ongoing fee arrangements and disclosure of lack of independence, which includes proposals to:
  - "enhance the existing ongoing fee arrangement provisions in the [Corporations Act 2001 No. 50 (Cth)]"; and
  - "require entities (a financial services licensee or authorised representative) who are authorised to provide personal advice to a retail client to disclose in writing to the client where they are not independent and why that is so";
- Recommendation 3.1 - Trustees of Registrable Superannuation Entities (RSE) should hold no other role or office, which includes a proposal to "prohibit superannuation trustees from having duties other than those arising from or in the course of the performance of its duties as a trustee of a superannuation fund";
- Recommendations 3.2 and 3.3 - Advice fees in superannuation, which includes a proposal to:
  - "remove a superannuation trustee's capacity to charge advice fees from MySuper products"; and
  - "remove the capacity of a superannuation trustee to charge advice fees to a member (other than fees for intra-fund advice) unless certain conditions are satisfied";
- Recommendation 3.4 and 4.1 - No hawking of superannuation, which includes a proposal to prohibit the hawking of superannuation and insurance products;
- Recommendation 3.8, 6.3, 6.4 and 6.5 - Superannuation regulator roles, which includes proposals to:
  - "adjust APRA and ASIC's roles in relation to superannuation to accord with the principles that APRA is the prudential regulator and ASIC the conduct and disclosure regulator";
  - "give ASIC joint responsibility for enforceable provisions in the [Superannuation Industry (Supervision) Act 1993 No. 78 (Cth)]"; and
  - "[ensure that] APRA remains responsible for prudential and member outcomes regulation in superannuation";
- Additional commitment in response to recommendation 4.2 - restricting use of the term "Insurance" and "Insurer", which includes a proposal to "make it a strict liability offence for a business to describe a product or service that they offer as insurance, if the product or service is not insurance, in circumstances where it is likely that the product or service could mistakenly be believed to be insurance";
- Recommendation 4.3 - Deferred sales model for add-on insurance, which includes a proposal to implement a deferred sales model for add-on insurance products "to promote

informed purchasing decisions by consumers in add-on insurance markets, by introducing a pause in the sales process between the consumer's purchase of the primary product and their decision to purchase add-on insurance";

- Recommendation 4.4 - Cap on vehicle dealer commissions, which includes a proposal to "provide ASIC with the power to impose a cap on commissions for add-on insurance products and insurance-like products such as warranties sold by car dealers";
- Recommendation 4.5 - Duty to take reasonable care not to make a misrepresentation to an insurer, which includes a proposal to implement "a duty to take reasonable care not to make a misrepresentation to an insurer for consumer insurance contracts";
- Recommendation 4.6 - Limiting avoidance of life insurance contracts, which includes a proposal to "strengthen consumer protection by including the extra condition for life insurers and prevent the insurer from inappropriately cancelling a contract in circumstances where the life insurer would still provide coverage";
- Recommendation 6.14 - Financial Regulator Assessment Authority, which includes a proposal to "establish an independent assessment authority to review the effectiveness of APRA and ASIC, and report on its findings to the [relevant] Minister"; and
- Additional commitment in response to recommendation 7.2 - ASIC directions power, which includes a proposal to "provide ASIC with powers to give directions to financial services and credit licensees consistent with the recommendations of the ASIC Enforcement Review Taskforce".

1.6 Policy responses to fintech: a cross-country overview

30 January 2020 - The Financial Stability Institute has published a policy paper that examines responses to fintech in around 30 jurisdictions.

Technological innovations in financial services (fintech) are increasingly transforming the way financial services are provided. While fintech opens opportunities, it also comes with potential risks. Financial authorities have responded to fintech developments in various ways. Based on survey responses from around 30 jurisdictions, this paper provides a cross-country overview of policy responses to fintech developments. In addition, building on the work by global standard-setting bodies and other international organisations, the paper proposes a conceptual framework through which to analyse policy responses to fintech, referred to as the "fintech tree". The fintech tree identifies three categories: fintech activities, enabling technologies and policy enablers.

View:

- Executive summary; and
- Financial Stability Institute paper "Policy responses to fintech: a cross-country overview".

1.7 SEC proposes amendments to modernise and enhance financial disclosures

30 January 2020 - The US Securities and Exchange Commission (the SEC) has announced that it has voted to propose amendments to modernise, simplify, and enhance certain financial disclosure requirements in Regulation S-K. The proposed amendments would eliminate duplicative disclosures and modernise and enhance Management's Discussion and Analysis

(MD&A) disclosures for the benefit of investors, while simplifying compliance efforts for companies. The SEC also announced that it is providing guidance on key performance indicators and metrics in MD&A.

The proposed amendments would eliminate Item 301 (selected financial data) and Item 302 (supplementary financial data), and amend Item 303 (management's discussion and analysis).

Among other things, the proposed amendments to Item 303 would:

- add a new Item 303(a), *Objective*, to state the principal objectives of MD&A;
- replace Item 303(a)(4), *Off-balance sheet arrangements*, with a principles-based instruction to prompt registrants to discuss off-balance sheet arrangements in the broader context of MD&A;
- eliminate Item 303(a)(5), *Tabular disclosure of contractual obligations,* given the overlap with information required in the financial statements and to promote the principles-based nature of MD&A;
- add a new disclosure requirement to Item 303, *Critical accounting estimates*, to clarify and codify existing SEC guidance in this area; and
- revise the interim MD&A requirement in Item 303(b) to provide flexibility by allowing companies to compare their most recently completed quarter to either the corresponding quarter of the prior year (as is currently required) or to the immediately preceding quarter.

The proposal also includes certain conforming amendments, including to Forms 20-F and 40-F, as appropriate.

View:

- SEC Proposed Rule; and
- SEC Guidance.

1.8 IOSCO publishes annual work program

30 January 2020 - The IOSCO Board (the Board) has published its 2020 annual work program, to further its core objectives of protecting investors, maintaining fair, efficient and transparent markets and addressing systemic risks.

The work program calls for IOSCO to continue its efforts on five specific priorities identified by the Board for 2019 while undertaking work on a new priority concerning rising levels of corporate debt and leveraged loans and the potential resulting risks in capital markets. It also refers to other important workstreams that are currently being carried out by IOSCO's eight Policy Committees.

In 2019, the Board identified the following specific priorities, all of which will continue to be priorities in 2020:

- crypto-assets;
- artificial intelligence and machine learning;
- market fragmentation;
- passive investing and index providers; and

- retail distribution and digitalisation.

The 2020 work program provides an update on these five existing priorities as well as an overview of the planned work on the new corporate debt and leveraged loan priority. Other important workstreams include those related to asset management, particularly in the areas of liquidity risk management and leverage, and IOSCO will continue its analysis of the Exchange Traded Funds marketplace.

IOSCO will maintain its focus on systemic risk in capital markets across its different work streams and continue to collaborate on this topic with other standard setting bodies and the Financial Stability Board (the FSB).

1.9 APRA sets out policy and supervision priorities for 2020

30 January 2020 - The Australian Prudential Regulation Authority (APRA) has set out its policy and supervision priorities for the next 12 to 18 months with an emphasis on fulfilling the four strategic goals of its Corporate Plan:

- maintaining financial system resilience;
- improving outcomes for superannuation members;
- improving cyber-resilience in the financial sector; and
- transforming governance, culture, remuneration and accountability (GCRA) across all APRA-regulated institutions.

Consistent with previous years, APRA's Policy Priorities document gives industry a forward view of APRA's planned changes to the prudential framework. This is now being supported by the publication of APRA's Supervision Priorities, outlining how the regulator's supervision function will be directed towards significant risks within the financial system, and acting to ensure those risks are well managed and mitigated.

Among APRA's key cross-industry policy priorities for 2020 are initiatives aimed at driving improvements in GCRA, including finalising a more robust prudential standard on remuneration, and updating prudential standards on governance and risk management.

Among APRA's other policy priorities are:

- strengthening crisis preparedness, including the development of a new prudential standard on resolution and recovery planning;
- completing the current review of the capital framework for authorised deposit-taking institutions to implement "unquestionably strong" capital ratios and the Basel III reforms;
- progressing a range of enhancements recommended by APRA's post-implementation review of the original superannuation prudential framework introduced in 2013; and
- continuing work on strengthening the capital framework for private health insurers.

In the supervision arena, APRA's 2020 priorities include:

- maintaining financial resilience, including through increased focus on recovery and resolution planning and stress testing;
- conducting a range of GCRA-related supervisory reviews and deep dives, and using entity self-assessments to drive greater accountability;

- encouraging underperforming superannuation funds to urgently improve member outcomes or exit the industry; and
- and more closely assessing institutions' capability to deal with emerging and accelerating risks, such as cybersecurity and climate change.

View materials:

- APRA's Policy Priorities - 2020;
- APRA's Supervision Priorities - 2020;
- APRA's Policy Priorities; and
- APRA's Supervision Priorities.

1.10 Research report shows U.S. securities class action filings reach record levels in 2019

29 January 2020 - US Securities fraud class action filings accelerated in 2019, according to a report released by Cornerstone Research and the Stanford Law School Securities Class Action Clearinghouse. The report, Securities Class Action Filings - 2019 Year in Review, finds that filing activity remains elevated well above historical levels by several key measures.

For the third year in a row, plaintiffs filed more than 400 securities class actions. In 2019, there were 428 securities class actions across federal and state courts, the highest number on record, with 268 core filings and 160 mergers and acquisitions (M&A) filings. This marks a historic high for core filings, surpassing even 2008 when class actions peaked in response to financial market volatility. Market capitalisation losses in 2019 eclipsed US$1 trillion for the second consecutive year.

The impact of the US Supreme Court's 2018 decision in *Cyan Inc. V Beaver County Employees Retirement Fund* continues to reverberate. In March 2018, the US Supreme Court issued a unanimous opinion allowing plaintiffs to assert claims under the *Securities Act 1933 (US)* (the Securities Act) in state courts. Under the Securities Act, s. 11 allows investors to pursue damages for alleged misrepresentations or omissions in securities registration statements. It is generally believed that the ruling will lead to more securities class action filings in state courts based on this claim.

The report, which includes expanded data on state court filings from 2010 to 2019, found that the Securities Act claims in state courts rose to 49 in 2019, a 40% increase from the previous year. Almost half of these had parallel actions in Federal Court.

Key trends:

- both Disclosure Dollar Loss (DDL) and Maximum Dollar Loss (MDL) decreased in 2019. DDL fell by 14% to US$285 billion, and MDL by 9% to US$1,199 billion as the size of the typical filing decreased;
- combined core federal filings in the Technology and Communication sectors grew by almost a third from 2018 and have more than doubled since 2017;
- Second Circuit core federal filings increased to 103, the highest number on record. The Ninth Circuit's core federal filings decreased by 25% to 52 filings;
- core federal filings against companies headquartered outside the US increased to 57, the highest total on record. The likelihood of a core federal filing against a non-US company increased from 4.8% to 5.6% from 2018 to 2019; and

- beginning in the latter part of 2018, companies with connections to the cannabis industry were increasingly the target of federal class action filings. There were six such filings in 2018 and 13 in 2019.

1.11 Report of the Bharara Task Force on insider trading

27 January 2020 - The US Bharara Task Force on Insider Trading (the Task Force) (with membership from academia, private practice, and the judiciary as well as former Department of Justice and SEC officials) has published its Report of the Bharara Task Force on Insider Trading reviewing and assessing the current state of US insider trading law and exploring proposals to improve it.

After studying the history and current state of insider trading law, reviewing the different legislative proposals that have been presented over the years, and receiving input from various interested groups, the Task Force has reached the following conclusions:

- reform that simplifies, clarifies, and modernises insider trading law is necessary and long overdue;
- a legislative solution, in the form of a new statute expressly setting out the elements of an insider trading offence, would be the best vehicle for such reform. While other measures, including regulatory rule-making, could provide incremental benefits, any steps short of a new statute will continue to be burdened by the uncertainty that accompanies existing common law; and
- to improve upon the current insider trading regime and to confront its most significant problems, the Task Force believes any new legislation should seek to apply the following key principles:
    - the language and structure of any statute should aim for clarity and simplicity;
    - the law should focus on material non-public information that is "wrongfully" obtained or communicated, as opposed to focusing exclusively on concepts of "deception" or "fraud," as the current case law does;
    - the "personal benefit" requirement should be eliminated; and
    - the law should clearly and explicitly define the knowledge requirement for criminal and civil insider trading enforcement, as well as the knowledge requirement for downstream tippees who receive material nonpublic information and trade on it.

The Task Force has drafted proposed text that could be used as a template for potential legislation.

1.12 SEC publishes observations on cybersecurity and resiliency practices

27 January 2020 - The US SEC's Office of Compliance Inspections and Examinations (OCIE) has issued examination observations related to cybersecurity and operational resiliency practices by market participants.

The observations highlight certain approaches taken by market participants in the areas of governance and risk management, access rights and controls, data loss prevention, mobile security, incident response and resiliency, vendor management, and training and awareness. The observations highlight specific examples of cybersecurity and operational resiliency practices and controls that organisations have taken to potentially safeguard against threats and respond in the event of an incident.

OCIE conducts examinations of SEC-registered investment advisers, investment companies, broker-dealers, self-regulatory organisations, clearing agencies, transfer agents, and others. It uses a risk-based approach to examinations to fulfill its mission to promote compliance with US securities laws, prevent fraud, monitor risk, and inform SEC policy.

1.13 Proposal to extend the Banking Executive Accountability Regime

22 January 2020 - The government has released a Proposals Paper on extending the Banking Executive Accountability Regime (the BEAR) to all APRA regulated entities and to make ASIC a joint administrator of the regime.

In its Final Report, the FSRC recommended that the BEAR be extended to all APRA regulated entities. It is proposed that the new Financial Accountability Regime will apply on a staggered basis to all general and life insurers, private health insurers, superannuation entities, and licensed non-operating holding companies.

In its response to the FSRC, the government also committed to extending the regime to solely ASIC regulated entities and will consult on how this extension should be implemented, following the implementation of the Financial Accountability Regime to prudentially regulated entities.

Financial Accountability Regime entities will be subject to accountability, key personnel, notification and deferred remuneration obligations. These obligations are aimed at ensuring that senior executives of these financial entities will be more accountable for the activities of the organisation for which they are responsible and, consistent with the BEAR, impose consequences for those who fail to perform their roles with competence, honesty and integrity.

The Proposals Paper is available on the Treasury website.

1.14 World Economic Forum report on reporting of sustainable value creation

22 January 2020 - The World Economic Forum has published the report Toward Common Metrics and Consistent Reporting of Sustainable Value Creation. The background to the report is "the practical challenges [for companies] involved in balancing short-term and longer-term business pressures in order to ensure that shareholders and other stakeholders prosper together. One of these challenges is the lack of consistency by which companies measure and report to investors and other stakeholders the shared and sustainable value they create."

The report proposes a common, core set of metrics and recommended disclosures that companies can use to align their reporting. The metrics and disclosures proposed in the report are organised in four pillars that are aligned with the United Nations (UN) Sustainable Development Goals and principal environmental, social and governance domains: Principles of governance, Planet, People and Prosperity. They are drawn wherever possible from existing standards and disclosures (such as the Global Reporting Initiative, Sustainability Accounting Standards Board, Task Force on Climate-related Financial Disclosures etc). Two related sets of metrics are proposed:

- core metrics: a set of 22 metrics and reporting requirements. These are primarily quantitative metrics for which information is already being reported by many firms (albeit often in different formats) or can be obtained with reasonable effort. They focus primarily on activities within an organisation's own boundaries; and
- expanded metrics: these tend to be less well established in existing practice and standards and have a wider value chain scope or convey impact in a more sophisticated or tangible way, such as in monetary terms. They represent a more advanced way of measuring and communicating sustainable value creation, and companies are encouraged to report against them as well, when material and appropriate.

1.15 Global ethics board proposes significant revisions to international auditor independence standards

21 January 2020 - The International Ethics Standards Board for Accountants (IESBA) has released two Exposure Drafts (EDs):

- Proposed Revisions to the Non-Assurance Services Provisions of the Code; and
- Proposed Revisions to the Fee-Related Provisions of the Code.

The EDs are aimed at strengthening the non-assurance services (NAS) and the fee-related independence provisions of the *International Code of Ethics for Professional Accountants (including International Independence Standards)* (the Code). The EDs represent a key milestone in two major strategic commitments of the IESBA in its current strategy and work plan.

Among the key changes proposed to the NAS provisions are:

- a prohibition on providing NAS to an audit client that is a public interest entity (PIE) if a self-review threat to independence will be created;
- further tightening of the circumstances in which materiality may be considered in determining the permissibility of a NAS;
- strengthened provisions regarding auditor communication with those charged with governance, including, for PIEs, a requirement for NAS pre-approval by those charged with governance; and
- stricter requirements regarding the provision of some NAS, including certain tax and corporate finance advice.

The NAS ED also includes enhanced guidance to assist firms in evaluating the level of threats to independence when providing NAS to audit clients.

Among the key proposed changes to the fee-related provisions are:

- a prohibition on firms allowing the audit fee to be influenced by the provision of services other than audit to the audit client;

- in the case of PIEs, a requirement to cease to act as auditor if fee dependency on the audit client continues beyond a specified period; and
- communication of fee-related information to those charged with governance and to the public to assist their judgments about auditor independence.

The Fees ED also includes enhanced guidance on identifying, evaluating and addressing threats to independence in relation to other fee-related matters, including the proportion of fees for services other than audit to the audit fee.

1.16 Investors call for improved workforce reporting

20 January 2020 - Reporting on workforce-related issues needs to improve to meet investor needs and reflect modern day workforces according to a new report from the UK Financial Reporting Council's Financial Reporting Lab (the Lab).

Workforce-related matters such as working conditions, changing contractual arrangements and automation have all become areas of increasing investor focus in recent years and the Lab's report reveals investors overwhelming support for clearer company disclosures.

The Lab's report provides practical guidance and examples on how companies can provide improved information to investors. It encourages companies to think of the workforce as a strategic asset and explain how it is invested in, underpinned by data on the composition, engagement, retention and diversity of the workforce.

Alongside the report, the Lab also published a summary of the report covering questions companies should ask themselves about their reporting on workforce matters.

1.17 FSB publishes annual report on non-bank financial intermediation

19 January 2020 - The FSB has published the Global Monitoring Report on Non-Bank Financial Intermediation 2019. The report presents the results of the FSB's annual monitoring exercise to assess global trends and risks from non-bank financial intermediation (NBFI).

The annual monitoring exercise is an important part of the FSB's policy framework to enhance the resilience of NBFI. It covers data up to end-2018 from 29 jurisdictions, which together represent over 80% of global Gross Domestic Product. The FSB focuses particularly on those parts of NBFI that may pose bank-like financial stability risks and/or regulatory arbitrage (i.e. the narrow measure of NBFI).

Main findings from the 2019 monitoring exercise include:

- total global financial assets grew by 1.4% to US$378.9 trillion in 2018, driven largely by banks. Assets of insurance corporations and pension funds remained largely unchanged, while those of Other Financial Intermediaries (OFIs) declined marginally as a result of stock market declines in late 2018 and, to a lesser extent, outflows from some of these entities;

- the narrow measure of NBFI grew by 1.7%, to US$50.9 trillion in 2018, significantly slower than the 2012-2017 average annual growth rate of 8.5%. It now represents 13.6% of total global financial assets. Collective investment vehicles with features that make them susceptible to runs grew by 0.4% in 2018, much slower than the 11% average annual growth rate from 2012-2017. At the end of 2018, such collective investment vehicles represented 72% of the narrow measure;
- lending by OFIs has continued to grow. OFI lending assets grew by 3.0% in 2018, largely driven by the euro area; and
- interconnectedness between banks and OFIs through credit and funding relationships has been largely unchanged since 2016. Investment funds and money market funds remain the largest OFI providers of credit to banks.

1.18 Review of 2019 shareholder activism

15 January 2020 - Lazard has published its Review of 2019 Shareholder Activism.

Key observations on the activist environment in 2019:

1. Activist Activity Returns to Multi-Year Trend After Record 2018

- 187 companies targeted by activists, down 17% from 2018's record but in line with multi-year average levels;
- aggregate capital deployed by activists ($42bn) reflected a similar dip relative to the $60bn+ level of 2017/2018;
- a record 147 investors launched new campaigns in 2019, including 43 "first timers" with no prior activism history; and
- Elliott and Starboard remained the leading activists, accounting for more than 10% of global campaign activity

2. Activism's Continued Influence Outside the US

- activism against non-US targets accounted for 40% of 2019 activity, up from 30% in 2015;
- multi-year shift driven both by a decline in US targets and an uptick in activity in Japan and Europe;
- for the first time, Japan was the most targeted non-US jurisdiction, with 19 campaigns and $4.5bn in capital deployed in 2019 (both local records);
- overall European activity decreased in 2019 (48 campaigns, down from a record 57 in 2018), driven primarily by 10 fewer campaigns in the UK; and
    - expanded activity in continental Europe - particularly France, Germany and Switzerland - partially offset this decline.

3. Record Number of M&A Related Campaigns

- a record 99 campaigns with an M&A related thesis (accounting for 47% of all 2019 activity, up from 35% in prior years) were launched in 2019;
    - as in prior years, there were numerous prominent examples of activists pushing a sale (HP, Caesars) or break-up (Marathon, Sony) or opposing an announced transaction (Occidental, Bristol-Myers Squibb);

- the $24.1bn of capital deployed in M&A-related campaigns in 2019 represented 60% of total capital deployed; and
    - the technology sector alone saw $7.0bn put to use in M&A related campaigns.

4. Activist Influence on Boards Continues

- 122 Board seats were won by activists in 2019, in line with the multi-year average;
    - consistent with recent trends, the majority of Board seats were secured via negotiated settlements (85% of Board seats);
    - 20% of activist Board seats went to female directors, compared to a rate of 46% for all new S&P 500 director appointees; and
- activists nominated a record 20 "long slates" seeking to replace a majority of directors in 2019, securing seats in two-thirds (67%) of the situations that have been resolved.

5. Outflow Pressure on Active Managers Intensifies

- actively managed funds saw $176bn in net outflows through Q3 2019, compared to ~$105bn in 2018 over the same period; and
- the "Big 3" index funds (BlackRock, Vanguard and State Street) continue to be the primary beneficiaries of passive inflows, collectively owning 19% of the S&P 500 - up from 16% in 2014.

6. Other Noteworthy Observations

- Environmental, social and corporate governance (ESG) focus continues to grow: over the past two years, the assets under management represented by signatories to the UN's Principles for Responsible Investment increased 26% to $86tn, and the number of assets in ESG-related exchange traded funds increased 300%.

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2. Recent ASIC Developments

2.1 Consultation on draft guidance on the new best interests duty for mortgage brokers

20 February 2020 - ASIC is consulting on draft guidance about the new best interests duty for mortgage brokers.

The new obligations were legislated by the Parliament in response to Recommendation 1.2 of the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry (the Royal Commission). From 1 July, the obligations will require mortgage brokers to act in the best interests of consumers and to prioritise consumers' interests when providing credit assistance.

ASIC's proposed approach to the guidance is outlined in Consultation Paper 327 Implementing the Royal Commission recommendations: Mortgage brokers and the best interests duty (CP 327). Consistent with the legislation, the draft guidance is high-level and principles-based, but also incorporates practical examples. The purpose of the guidance is to explain the obligations introduced by the government, it does not prescribe conduct or impose additional obligations.

The draft guidance is structured around the key steps common to the credit assistance process of brokers, such as gathering information, considering the product options available and presenting options and a recommendation to the consumer. ASIC expects that the new obligations will improve competition in the home lending market.

ASIC seeks public comment on the draft guidance by 20 March 2020.

ASIC intends to publish final guidance before the obligations commence on 1 July 2020.

View:

- Consultation Paper 327: Implementing the Royal Commission recommendations: Mortgage brokers and the best interests duty.

2.2 Report reviewing trustees' Protecting Your Superannuation Package communications

12 February 2020 - ASIC has released the findings from its recent review of superannuation trustees' communications with their members about changes introduced through the Treasury Laws Amendment (Protecting Your Superannuation Package) Act 2019 No. 16 (Cth) (the TLA(PYSP) Act).

The TLA(PYSP) Act reforms were introduced to protect the superannuation savings of Australians from erosion due to inappropriate fees and insurance premiums as well as to reduce unintended multiple low balance accounts. The key changes were designed to benefit members with low superannuation balances (below $6,000) and those with accounts that have been inactive for 16 months.

REP 655 presents findings from ASIC's review of a broad range of communications material from 12 superannuation funds with six million member accounts. The funds were chosen on the basis that, because of their relatively high number of inactive accounts, they were likely to be considerably affected by the TLA(PYSP) Act reforms.

ASIC undertook the review because of concerns that unbalanced trustee communications could undermine the effectiveness of the TLA(PYSP) Act in producing benefits for members.

Some of the communication material reviewed by ASIC did not provide sufficient context for the reforms or adequately explain what the changes meant for members. Some communications used complex language, promoted a particular option that may not have been suitable for the member or failed to include relevant information about the member's existing superannuation arrangements that would have been helpful.

ASIC will provide feedback directly to the trustees who participated in the Protecting Your Superannuation Package communications review. Additionally, ASIC also examined disclosures about TLA(PYSP) Act reforms from a number of other trustees and third parties. Some of those trustees have made changes to their disclosure practices as a result.

While the communications review is not exhaustive, the findings are important to all trustees framing communications to members on TLA(PYSP) Act and related reforms, as well as other topics more broadly. REP 655 also provides information and tips for trustees and sets out ASIC's expectations about future communications.

ASIC will continue to monitor trustee communications in relation to TLA(PYSP) Act and related reforms and consider taking regulatory action where further issues are identified.

View:

- REP 655.

2.3 Review of 30 June 2019 financial reports

7 February 2020 - ASIC has announced the results from its review of the 30 June 2019 full-year financial reports of 200 entities.

Arising from the review, ASIC has made inquiries of 47 entities on 80 matters. The largest number of inquiries continue to relate to impairment of non-financial assets and inappropriate accounting treatments.

ASIC states that it continues to find instances where companies have made unrealistic and unsupportable assumptions about future cash flows. ASIC issued Information Sheet 203 Impairment of non-financial assets: Materials for directors (INFO 203) in June 2015 to assist directors and audit committees in considering whether the value of non-financial assets shown in a company's financial report continues to be supportable.

Directors and auditors should also focus on the impact of the newer accounting standards on revenue, financial instruments, and leases, which can materially affect reported financial position and results.

ASIC's risk-based surveillance of the financial reports of public interest entities for reporting periods ended 30 June 2010 to 31 December 2018 has led to material changes to 4 to 5% of the financial reports of public interest entities reviewed by ASIC. The main changes related to impairment of assets, revenue recognition and expense deferral.

ASIC publicly announces when a company makes material changes to information previously provided to the market following inquiries by ASIC. In addition to improving the level of market transparency, these announcements are intended to make directors and auditors of other companies more aware of ASIC's concerns so that they might avoid similar issues.

View:

- ASIC review of 30 June 2019 financial reports.

2.4 Report on applications for relief - April 2019 to September 2019

3 February 2020 - ASIC has granted over 400 applications for relief between 1 April 2019 and 30 September 2019.

ASIC's latest report, Overview of decisions on relief applications (April 2019 to September 2019) (REP 654), outlines decisions on relief applications and highlights ASIC's efforts to reduce red-tape and achieve a practical, positive outcome for companies seeking regulatory flexibility, without harming stakeholders.

During the reported period, ASIC granted relief from provisions of the Corporations Act 2001 No. 50 (Cth) (the Corporations Act) or the National Consumer Credit Act 2009 No. 134 (Cth) in relation to 420 applications.

The reporting of ASIC's decisions on relief applications aims to provide transparency about its decision making and to better inform businesses about the circumstances in which ASIC will grant relief.

REP 654 lists publications released by ASIC during the period that may be relevant to prospective applicants for relief.

The report also provides examples where ASIC has exercised, or refused to exercise, its exemption and modification powers under the Corporations Act.

View:

- REP 654; and
- Read previous relief application reports.

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3. Recent ASX Developments

3.1 Amendments to ASX 24 Operating Rules

On 10 January 2020, the Australian Securities Exchange (the ASX) released an update to the ASX 24 Operating Rules. Procedure 3200.10 regarding Block Trades in the S&P/ASX 200 Gross Total Return Index Futures has been amended to have an Anomolous Order Threshold / No Cancellation Range framework in place for the contract in the event of an error if liquidity were to build in the distant months.

The notice is available on the ASX website.

3.2 Amendments to ASX Settlement Operating Rules Procedures

On 15 January 2020, the ASX released an update to the ASX Settlement Operating Rules Procedures. Nyrada Inc. has been included in Schedule 1 as FOR Financial Products.

The notice is available on the ASX website.

3.3 Reports

On 6 February 2020, the ASX released the ASX Group Monthly Activity Report for January 2020.

On 13 February 2020, the ASX released the Half-Year Financial Statements for FY 2020 and the Half-Year Dividend Notification.

4. Recent Takeovers Panel Developments

4.1 Smoke Alarms Holdings Limited 02R - Review panel decision

30 January 2020 - The review Panel has affirmed the decision of the initial Panel to make a declaration of unacceptable circumstances in relation to the affairs of Smoke Alarms Holdings Limited.

The review Panel has accepted undertakings from Smoke Alarms Holdings Limited (SAH), Mr Randall Deer and Fast Future Pty Ltd as trustee for Fast Future Trust (Fast Future).

The combined effect of the undertakings is that a Convertible Note Issue Agreement (the Agreement) between SAH and Fast Future will be terminated, SAH and Fast Future will enter into a 12 month debt facility for an amount of $3,684,000 (with amounts previously advanced pursuant to the Agreement to be treated as an advance under the new facility) and SAH will issue a letter to its shareholders explaining the effect of the Panel's declaration and the undertakings.

The review Panel considered that the undertakings sufficiently remedy the unacceptable circumstances as the termination of the Agreement removes the control effect of the funding. Accordingly, the review Panel revoked the initial Panel's orders.

The Panel has published its reasons for the decision on the Takeovers Panel website.

4.2 Energy Resources of Australia Limited 02R - Review panel decision

20 January 2020 - The review Panel has affirmed the decision of the initial Panel to make a declaration of unacceptable circumstances in Energy Resources of Australia Limited and varied the initial Panel's orders.

The review Panel was satisfied that orders prohibiting Rio Tinto from compulsorily acquiring shares in Energy Resources of Australia Limited (ERA) as a consequence of ERA's entitlement offer would be unfairly prejudicial to Rio Tinto and therefore removed those orders.

The review Panel considered it was appropriate to require Rio Tinto to form intentions regarding compulsory acquisition in the event that Rio Tinto becomes a 90% holder in ERA's ordinary shares (as a result of the entitlement offer and underwriting agreement) and for ERA to provide further disclosure of Rio Tinto's intentions to its shareholders. The review Panel also considered it was appropriate to further extend the entitlement offer timetable by 15 business days for ERA shareholders to consider the additional disclosure.

The Panel has published its reasons for the decision on the Takeovers Panel website.

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5. Recent Research Papers

5.1 When is an individual investor not in need of consumer protection? A comparative analysis of Singapore, Hong Kong, and Australia

In Singapore, Hong Kong and Australia, standard retail investor protection laws do not apply to special categories of individual investors. Issuers and intermediaries can avoid preparing a prospectus and assessing the suitability of a financial product or investment when financial advice is given for these investors. However, with the increasing complexity of products and potentially unregulated alternative investments such as crypto-assets, this legal framework is increasingly being debated and challenged. More disclosure is not the answer.

This paper explores the rationale behind the special categories, the implications of falling into these categories from a consumer protection perspective and the current debates as to whether these special categories should continue to be recognised. The paper argues that the existing wealth or income based criteria that determine eligibility are anachronistic and inappropriate. Instead, all individuals making investment decisions should have the benefit of a rating framework that is based on both complexity and risks and be subject to a suitability test in the case of complex products.

View:

- When Is an Individual Investor Not in Need of Consumer Protection? A Comparative Analysis of Singapore, Hong Kong, and Australia.

5.2 The impact of whistleblowing awards programs on corporate governance

Since the introduction of a whistleblower awards program by the US SEC in 2010, securities regulators in other countries, including Canada, have adopted, or are considering adopting, similar programs. For example, in 2016, the Ontario Securities Commission adopted its own whistleblower award program. Although the primary reason for these programs is to encourage the reporting of securities violations to the regulator, they could also have an impact on corporate governance. This is because the implementation of such a program may prod companies to design, and then instigate, a more effective internal whistle-blowing system. A truly successful internal whistle-blowing system can enable a company to detect and correct potential wrongdoing before it causes significant harm. This article closely examines this connection between whistleblowing award programs, companies' compliance and risk management systems, and how a whistleblowing award program might well result in more effective internal whistleblowing systems without the need for a regulator to resort to the imposition of prescriptive rules. As such, this article reflects upon how whistleblower award programs fit within new governance regulatory theory that challenges traditional "command-and control-type" regulation in favour of an outcome-driven approach.

View:

- The Impact of Whistleblowing Awards Programs on Corporate Governance.

5.3 Shifting contours of directors' fiduciary duties and norms in comparative corporate governance

Corporate law and corporate governance are often called upon to address problems in international and transnational contexts. Financial markets are global and the problems in those markets are often similar, if not identical, even though the capital market structure across jurisdictions differs significantly. The beginning of the 21st century was marked by a spate of international corporate scandals, and the 2007-2009 global financial crisis reflected the global "interconnectedness" of contemporary international capital markets.

These events highlighted the issue of accountability for wrongful conduct by company directors and officers. Modern corporate governance is highly fragmented, encompassing an array of techniques to control the improper exercise of discretion and conflicts of interest. According to Professor Gilson, it is "a braided framework" that encompasses, not only autonomous legal rules, but also non-binding norms.

This article analyses, from a comparative perspective, two core aspects of this "braided framework". First, the article considers fiduciary duties. It argues that, although there are broad similarities in the scope and operation of fiduciary duties in common law jurisdictions, such as the US, UK and Australia, at a more granular level, there are important differences, which may affect the accountability of directors and officers.

Secondly, the article examines corporate codes. Although generally non-binding, corporate codes can create powerful norms concerning the role of directors and officers and the exercise of their powers. These codes may also interact with fiduciary duties in complex and interesting ways, either complementing, or creating tensions with, those duties. Yet, such codes are by no means homogeneous, and substantive differences can often be traced to the identity of the actors responsible for writing them.

View:

- Shifting Contours of Directors' Fiduciary Duties and Norms in Comparative Corporate Governance.

5.4 Regulating derivatives: A fundamental rethinking

The conventional wisdom is that derivatives are exotic and uniquely risky, although innovative, financial instruments. That perception has given rise to a regulatory patchwork described as confusing, incomplete, and contradictory. This article rethinks how derivatives should be regulated. It begins by de-mystifying derivatives. In contrast to the industry-derived categories, the article shows that derivatives can be deconstructed more intuitively, by their economic functions, into two categories of traditional legal instruments-option contracts and guarantees. Being neither exotic nor uniquely risky, most derivatives should be regulated like those traditional instruments. The article then explains why at least one subset of guarantees - financial guarantees with systemically important counterparties, which are epitomised by credit-default swap derivatives - can seriously threaten economic stability, and why the absence of an insurable-interest requirement can further magnify that threat. Finally, the article examines how to design regulation that efficiently targets that threat.

View:

- Regulating Derivatives: A Fundamental Rethinking.

6. Recent Corporate Law Decisions

6.1 Federal Court delivers win for ASIC in binary options case against One Tech Media

(By Sarah-Anne Butler, King & Wood Mallesons)

Australian Securities and Investments Commission v One Tech Media Ltd [2020] FCA 46 (5 February 2020) Federal Court of Australia, Davies J

(a) Summary

ASIC brought an action in the Federal Court against One Tech Media Limited (One Tech), along with a number of other defendants, in relation to the pressure sale of binary options to Australian investors. ASIC successfully alleged that One Tech and certain other defendants had contravened sections of the Corporations Act 2001 No. 50 (Cth) (the Corporations Act) and the Australian Securities and Investments Commission Act 2001 No. 51 (Cth) (the ASIC Act) in connection with those sales and trading in the options.

Davies J found that One Tech conducted a financial services business in Australia without holding an Australian financial services licence (AFSL), failed to provide product disclosure statements in respect of the options, misled and deceived its customers, and engaged in both dishonest and unconscionable conduct. Davies J also found that certain other defendants had contravened sections of the Excise Tax Act 1985 (CA) by "arranging" for a person to deal in a financial product by providing "paying agency services" to One Tech in relation to the options.

(b) Facts

One Tech, a company based in the Seychelles and later in the Marshall Islands, offered binary options and trading in those options through its websites. Binary options are a derivative for the purposes of the Corporations Act.

One Tech's websites were accessible in Australia and there was evidence that Australian customers had traded options through its websites, whilst One Tech did not hold an AFSL. It was established that One Tech also issued binary options without issuing a product disclosure statement.

Additionally, it was alleged that One Tech's websites contained a number of misleading or deceptive representations in relation to:

- the profits and returns generated by trading in binary options;
- the expertise of its appointed brokers; and
- certain trades that were held out to be "insured" or "guaranteed" such that the customer could not lose on those trades.

(c) Decision

(i) One Tech

Failure to hold an AFSL

Davies J found that One Tech had contravened s. 911A of the Corporations Act by carrying on a business of trading in binary options through its websites without holding an AFSL. This was because:

- the evidence showed that the websites were accessible in Australia and customers in Australia traded through the websites;
- the binary options offered for trade through the websites were "derivatives" and hence "financial products" for the purposes of the Corporations Act; and
- One Tech provided financial services by issuing binary options, and, by entering into legal relationships with website customers to engage in binary options trading.

Failure to provide product disclosure statements

It was also held that by offering to issue binary options through its websites without providing a product disclosure statement, One Tech contravened s. 1012B(3) of the Corporations Act.

Misleading or deceptive conduct and dishonest conduct

Davies J found that each of the representations made to One Tech's customers outlined above was false or misleading, and that One Tech had conducted itself dishonestly. Those representations were misleading and deceptive as One Tech made them, knowing them to be false. This was supported by the investors' affidavits, which demonstrated that in the long term, all investors lost their money, regardless of the size of their investment. Further, investors lost on trades although they were encouraged to continue trading with promises these trades would be "insured" or "guaranteed", and it was clear that the representations had induced investors in Australia to apply, acquire and trade in binary options through One Tech's website.

Unconscionable conduct

It was also found that One Tech engaged in unconscionable conduct in connection with the supply of financial services in breach of s. 12CB(1) of the ASIC Act, with Davies J noting at [78] that "[a] systemic practice directed to exploiting consumers is borne out by the evidence in this case". The relevant factors in making this decision included the investors being in a weaker bargaining position than One Tech, the investors having a limited understanding of the documents relating to the operation of their accounts, and the unfair tactics used by One Tech to entice investors to place trades and deposit substantial amounts of money with it.

(ii) Other defendants

A key issue was whether certain other defendants "arranged for" One Tech to offer trading in binary options by providing paying agency services to One Tech. As the term "arranging for" is not defined in the Corporations Act, Davies J referred to the dictionary definition at [132]:

"The verb 'to arrange' has a broad meaning which includes 'to make preparations' (Macquarie Dictionary, 7th edition, p. 76) and there is no warrant for giving the term 'arranging for' in the context of s. 766C(2) of the Corporations Act a narrow or restricted meaning."

Because the paying agency services provided by the relevant defendants were found to be integral to the binary options trading through the websites, these defendants were held to have contravened s. 911A of the Corporations Act by "arranging for" One Tech to issue binary options without holding an AFSL.

These defendants were also found to have contravened s. 1012B(3) of the Corporations Act by offering to arrange for the issue of financial products to website customers without giving them a product disclosure statement.

However, they were found not to have provided a custodial or depository service within the meaning of s. 766E(1) of the Corporations Act, because they did not use the funds themselves to generate a financial return for the investors, nor did they intend for the deposited funds to be used to generate a financial return for the investors.

6.2 An application to bring proceedings on behalf of a company against its directors where the applicant is both a shareholder and disgruntled former employee

(By David Tilley, Ashurst)

D'Ortenzio v Charles Parletta Real Estate Pty Ltd [2020] SASC 9 (31 January 2020) Supreme Court of South Australia, Bochner J

(a) Summary

This case concerned an application by a shareholder for leave to bring proceedings on behalf of a company against its directors. The plaintiff, Ms D'Ortenzio, held 15% of the shares in Charles Parletta Real Estate Pty Ltd. However, she was also a former (and disgruntled) employee of the company. At all times the two directors, Mr Parletta (who ran the business) and his wife Mrs Parletta, held the remaining 85% of the shares in the company. The plaintiff alleged that the directors had breached their fiduciary duties to the company, citing concerns that significant private expenses were being paid by the company without proper accounting. Ultimately, Bochner J was satisfied that the five criteria in s. 237(2) of the Corporations Act 2001 No. 50 (Cth) (the Corporations Act) for granting leave had been met, and granted leave for the plaintiff to commence proceedings against the directors on behalf of the company.

(b) Facts

The plaintiff had worked at the company as an employee since 1990, in a number of different capacities (including as office manager), and additionally became a shareholder when in 2007 and 2015 Mr Parletta gave her a total of 15% of the shares in the company. Following the breakdown of their working relationship in 2017, Mr Parletta terminated the plaintiff's employment. In separate proceedings the plaintiff pursued the company for wrongful dismissal (for which she was unsuccessful in the Fair Work Commission) and underpayment (for which she was successful in the South Australian Employment Tribunal). The plaintiff is also currently pursuing oppression proceedings against the company.

In alleging a breach of directors' duties, the plaintiff relied on an independent auditor's report of the company's 2016 accounts in which the auditors disclaimed an opinion on the financial reports. In doing so, the auditors cited a failure to "readily differentiate between private and business expenditure".The auditors described the problem as "pervasive", providing nine examples in which it appeared that the recorded expenses had no relationship with the carrying on of the business.

(c) Decision

Bochner J faced a preliminary issue about the regard to be had to the findings of the Fair Work Commission and South Australian Employment Tribunal. Faced with conflicting findings such as the credibility of witnesses on tangentially related matters, Bochner J found the competing decisions to be irreconcilable and considered that the only approach to take was to disregard both decisions.

Thus, Bochner J turned to consideration of the five criteria under s. 237(2) of the Corporations Act. The criteria are such that if satisfied, the Supreme Court of South Australia (the Court) is compelled to grant the plaintiff leave to bring the proceedings on behalf of the company. The arguments and Bochner J's decisions concerning each criteria are canvassed below.

(i) Is it probable that the company would not itself bring the proceedings? (s. 237(2)(a))

It was conceded by the defendant that it would not itself bring the proceedings sought by the plaintiff.

(ii) Is there a serious question to be tried? (s. 237(2)(b))

It was noted by reference to *O'Meara v FWV Starke Holdings Pty Ltd (No 3)* [2007] SASC 305 that there was a "relatively low threshold" for the Court to be satisfied that there was a serious question to be tried. Bochner J said that such a threshold was satisfied on the basis of the allegations in the plaintiff's affidavits, particularly the auditor's report. Bochner J considered Mr Parletta's attempts to implicate the plaintiff in the irregular transactions was "disingenuous and misconceived", as it was always the responsibility of the directors to ensure that the transactions were recorded appropriately in the company's accounts. In addition to the conclusions of the auditor's report, Bochner J referred to the misleading description of "advertising" on numerous company cheque butts (raising concerns that Mr Parletta had used the company's finances to fund personal expenditure) and the payment of rent, rates and taxes for a premises occupied by the company, subleased in Mr Parletta's own name (raising concerns that Mr Parletta had improperly benefited at the expense of the company).

(iii) Is the plaintiff acting in good faith? (s. 237(2)(c))

In *Swansson v R A Pratt Properties Pty Ltd* (2002) 42 ACSR 313, the Court discussed the two factors to which the Court should have regard in determining whether the applicant was acting in good faith. These factors were whether the applicant honestly believed that a good cause of action existed, and whether the applicant was seeking to bring the derivative suit for such a collateral purpose as would amount to an abuse of process. Although there was significant animosity between the plaintiff and Mr Parletta, and the plaintiff was bringing additional oppression proceedings against the company, Bochner J did not consider that this meant that the plaintiff was acting in the absence of good faith. Further, given the broad statements made by the auditor in disclaiming his opinion, Bochner J was satisfied that the plaintiff was motivated by a concern that there had been misappropriation of company funds by its directors.

(iv) Is the proposed action in the best interests of the company? (s. 237(2)(d))

For the proposed action to be in the best interests of the company, the Court must be satisfied on the balance of probabilities, having regard to all of the relevant circumstances. Bochner J was satisfied that although the plaintiff was also bringing oppression proceedings against the company in her personal capacity, the proceedings she sought in this case were to be on behalf of the company. Bochner J further noted that in the event that the proposed action was successful, the company and its other shareholders would have the benefit of the outcome.

(v) Did the plaintiff give the defendant appropriate notice of this application? (s. 237(2)(e))

Mr Parletta submitted that the plaintiff's notice fell short of the requirements of the Corporations Act as the matters set out in the notice did not contain any substance, and were continually changing with each subsequent affidavit (the plaintiff filed five affidavits in total). However, Bochner J rejected these submissions, preferring to consider the matters detailed in each affidavit as different manifestations of the same, unchanging reason for bringing the application - namely, that significant private expenses were being paid by the company, without proper accounting.

Given that each of the five criteria were satisfied, Bochner J was compelled under s. 237(2) of the Corporations Act to grant the plaintiff leave to commence the proposed proceedings on behalf of the company.

6.3 Time for a splash! Court grants pooling order in Watch Works and Cobbler Plus winding-up

(By Radhika Kayarat, Corrs Chambers Westgarth)

Re Watch Works Australia Pty Ltd (in liq) & Anor; Ex Parte Francis & Ors [2020] WASC 6 (20 January 2020) Supreme Court of Western Australia, Vaughan J

(a) Summary

The Supreme Court of Western Australia (the Court) determined that two linked companies were to be a "pooled group" pursuant to s. 579E of the Corporations Act 2001 No. 50 (Cth) (the Corporations Act) in order to satisfy the external debts payable by both companies.

(b) Facts

(i) What happened

Watch Works Australia Pty Ltd (Watch Works) and Cobbler Plus Services Pty Ltd (Cobbler Plus) (together the Companies) both conducted a watch and shoe repair business, operating between them a total of 120 outlets across Australia. Although operating under different trading names, the Companies both provided cobbler, watch repair and key cutting facilities to customers.

In addition to providing similar goods and services, the Companies shared a number of similarities including:

- the same sole director;
- the Watch Works and Cobbler Plus branded stores were managed by the same area and store managers;
- all employees of the Companies were employed by Watch Works; and
- stock-in-trade held and used by the Companies' business was controlled by another company, Soderberg Group Pty Ltd (in liq), which provided a head office function to both Companies.

Although the Companies maintained a number of bank accounts, all revenue funds were routinely swept into a single Watch Works bank account which was routinely used to pay both Companies' operating expenses. The Companies' records also did not delineate between creditors of each company. The result being it could not be discerned with certainty which assets were owned by, and which liabilities are attributable to, one or both Companies.

The Companies went into administration and subsequently into liquidation in August 2019 after their creditors passed resolutions that the Companies be wound up.

(ii) What issues were before the Supreme Court?

The plaintiff liquidators sought orders pursuant to s. 579E(1) of the Corporations Act that Watch Works and Cobbler Plus be pooled as a group for the winding-up. The plaintiff liquidators also sought a further ancillary order under s. 579G(1)(d) of the Corporations Act to modify the operation of the Corporations Act in relation to the winding-up so that the assets of a trust, of which Watch Works was trustee, became available to meet each debt payable by, and each claim against, the Companies.

(iii) What is a pooling order?

A pooling order is a decision to treat the affairs of a group of companies as if it were a single external administration.

Section 579E(2) of the Corporations Act outlines the consequences of a pooling order. First, each company is taken to be jointly and severally liable for each debt payable by and claim against each other company in the group. Second, each intra-group debt and claim is extinguished.

A liquidator may make an application to the Court for a pooling order under s. 579E(11) of the Corporations Act.

Section 579E of the Corporations Act sets out a number of matters which should be taken into account when deciding to grant a pooling order, including:

- whether it is just and equitable in the circumstances; and
- the extent to which creditors of any of the companies in the group may be advantaged or disadvantaged by the making of the order.

Under s. 579E(10)(a) of the Corporations Act, the Court must not make a pooling order if it is satisfied that it would materially disadvantage an eligible unsecured creditor where that creditor has not consented to the making of the order.

Relevantly, s. 579E(1)(b)(iv) of the Corporations Act provides that where the Court is satisfied two or more companies are being wound up and one or more companies in the group "own particular property that is or was used, or for use, by any or all of the companies in the group in connection with a business.carried on jointly by the companies in the group", the Court may determine the companies are a pooled group if it is satisfied that it is just and equitable to do so. This means the available assets in each winding-up can be used to satisfy the external debts of all the companies in the pooled group.

(c) Decision

The common management, accounts and processes for dealing with creditors led Vaughan J to find the Watch Works and Cobbler Plus store branded businesses were carried on jointly by the Companies and met the legislative requirements for the grant of a pooling order.

His Honour found, with some reservation, that there would be no material disadvantage to Cobbler Plus' unsecured creditors if the pooling order was made. If a pooling order was made Cobbler Plus' ordinary unsecured creditors would receive nothing. If the order was not made they would receive 1.47 cents in the dollar, as an optimistic upper estimate. The average value of Cobbler Plus unsecured creditors' claims was $87,747. Based on the 1.47 cents per dollar estimate, the average dividend distribution would be around $340. There was also a realistic chance the return would be lower than 1.47 cents per dollar, or nothing at all. His Honour concluded this low return, which in itself was uncertain, was not material so did not materially disadvantage Cobbler Plus' unsecured creditors for the purposes of s. 579E(1)(a) of the Corporations Act. His Honour noted that "the law does not bother with small and insignificant matters". Though the priority unsecured creditors of Watch Works, the employees of the Companies, would be afforded an advantage over the ordinary unsecured creditors of Cobbler Plus, and despite the Cobbler Plus' unsecured creditors not consenting to the order, his Honour concluded that it was just and equitable to make the pooling order in the circumstances.

However, Vaughan J did not agree with the plaintiff liquidators' characterisation of the "particular property" for the purpose of s. 579E(1)(b)(iv) of the Corporations Act. His Honour found the relevant particular property was not the funds paid into the Watch Works liquidation account, but rather the bank account itself as a chose in action. Despite the disagreement on what constituted the particular property, the existence of the particular property meant that s. 579E(1)(b)(iv) of the Corporations Act was satisfied.

The ancillary order sought under s. 579G(1)(d) of the Corporations Act in this case was novel. The liquidators "presented an elaborate argument" that the section was broad enough to modify the application of the Corporations Act so as to permit what is otherwise precluded under general law, specifically to allow trust assets to be used to meet non-trust liabilities. His Honour dismissed this argument and declined to make the order as being unnecessary on the evidence before the Court.

The key takeaways are:

- factual circumstances will be closely scrutinised by the courts when deciding to grant a pooling order. Close attention will need to be paid to what is a material disadvantage to creditors and whether any disadvantage will meet the threshold; and
- courts will be reluctant to interpret provisions modifying the application of the Corporations Act broadly.

6.4 Should an exclusive jurisdiction clause apply to a proposed scheme of arrangement?

(By Ken Ooi, Herbert Smith Freehills)

Tiger Resources Ltd, in the matter of Tiger Resources Ltd [2019] FCA 2186 (23 December 2019) Federal Court of Australia, Gleeson J

(a) Summary

At the first court hearing for a proposed creditors' scheme of arrangement (scheme) involving Tiger Resources Limited (Tiger), Gleeson J considered, amongst other things, whether the Federal Court of Australia's (the Court) approval of a scheme would contravene an exclusive jurisdiction clause, and accordingly whether the proceeding should be permanently stayed, as proposed by one of the creditors relevant to the scheme. Despite there being limited authority on this issue, her Honour found that a scheme was not properly characterised as the "settlement of a dispute" between contracting parties under the exclusive jurisdiction clause of the relevant financing agreement.

Gleeson J held that the application for a stay of the proceeding be refused and granted orders to convene a creditor meeting in respect of the scheme.

(b) Facts

Tiger is a public company listed on the ASX and is the ultimate holding company of entities incorporated in foreign jurisdictions, being the Democratic Republic of Congo (DRC), the British Virgin Islands and South Africa. Tiger has suffered from financial difficulties for some time and trading in Tiger shares on the ASX was voluntarily suspended in early 2017.

(i) The Scheme Creditors

The main operating company within the Tiger group of companies is Société d'Exploitation de Kipoi S.A (SEK), a company incorporated in the DRC. SEK has secured borrowings from Taurus Mining Finance Fund L.P. (Taurus), QMetco Limited (QMetco) and International Finance Corporation (IFC) who are the creditors relevant to the scheme (together, the Scheme Creditors). Tiger and other members of the Tiger group of companies guarantee borrowings from the Scheme Creditors.

The borrowings from the Scheme Creditors are on a "senior" basis and "super senior" basis. Tranche A of SEK's debt comprises the senior facility, whereas Tranches D and E of SEK's debt comprise the super senior facility. Tranches D and E relevantly have priority over Tranche A.

- Tranche A is a loan facility provided by each of the Scheme Creditors. Under that facility, as at 30 November 2019:
    - QMetco was owed approximately US$20,306,000 comprising principal and interest;
    - Taurus was owed approximately US$144,855,000 comprising principal and interest; and
    - IFC was owed approximately US$55,932,000 comprising principal and interest.
- Tranche D is a loan facility provided by Taurus pursuant to which approximately US$13,731,000 of principal and interest was outstanding as at 30 November 2019; and
- Tranche E is a loan facility provided by QMetco pursuant to which approximately US$12,191,000 of principal and interest was outstanding as at 30 November 2019.

As Tiger is the guarantor of the relevant debts, the Scheme Creditors are also contingent creditors of Tiger and capable of being the subjects of the scheme.

(ii) Scheme of arrangement

The scheme proposed:

- the compromise of the Tranche A debt in return for the Scheme Creditors receiving equity in Tiger (the Scheme Creditors who hold Tranche A debts totalling $221.1 million will hold Tranche A debts totalling $70 million after implementation of the Scheme. In return, after implementation of the Scheme, they will hold 99.24% of the issued capital in Tiger);
- amending the maturity date for the remaining Tranche A debt from 31 January 2024 to 31 December 2025, and removing certain amortisation arrangements; and
- extending the maturity period in respect of the Tranche D and Tranche E debts held by Taurus and QMetco to 31 December 2024.

(iii) The scheme convening hearing

Tiger applied to the Court for an order to convene a creditors' meeting in respect of the scheme. IFC opposed the order to convene the scheme meeting, and also applied for an order that the proceeding be permanently stayed by interlocutory process. In light of its stay application, IFC was ordered to be added as a defendant to the proceeding. At the hearing, amongst other things, IFC:

- (**Stay Application**): contended that the proceeding should be permanently stayed because it was brought in contravention of an exclusive jurisdiction clause in favour of the courts of England or, alternatively, on *forum non conveniens* grounds; and
- (**Jurisdiction**): disputed that the proposed scheme was a "compromise or arrangement" within the meaning of s. 411(1) of the Corporations Act 2001 No. 50 (Cth) (the Corporations Act) and that the proposed scheme was between Tiger and a class of its creditors, and that these issues must be determined for the Court to be satisfied of its jurisdiction.

(c) Decision

Gleeson J held that the application for a stay of the proceeding be refused and granted orders to convene a creditor meeting in respect of the scheme.

(i) Stay application

With regard to IFC's position that the proceeding should be permanently stayed, the relevant provision of the financing agreement provided that:

"...the parties agree that the courts of England shall have exclusive jurisdiction to settle any dispute arising out of or in connection with this Agreement (including any dispute regarding non-contractual obligations and any dispute regarding the existence, validity or termination of this Agreement or the consequences of its nullity) (a "Dispute") and, for such purposes, irrevocably submit to the jurisdiction of such courts...".

Although Gleeson J did accept IFC's position that an exclusive jurisdiction clause is to be construed liberally and acknowledged the breadth of the words "arising out of or in connection with", she was not persuaded that this should be read as an agreement to confer exclusive jurisdiction on the English courts in relation to the scheme. Her Honour also noted that this argument was directed solely to the language of the clause, without consideration of the other factors that bear on a proper construction of a commercial contract.

In particular, her Honour was not persuaded that the scheme could be properly characterised as the "settlement of a dispute" between contracting parties, within the meaning of the exclusive jurisdiction clause, where the proceeding ultimately sought the Court's approval of an arrangement based upon Tiger's satisfaction of the requirements for approval.

In addressing IFC's argument of *forum non conveniens*, Gleeson J disagreed that the Court was a "clearly inappropriate forum", noting that it was *prima facie* the most appropriate forum for resolving issues concerning the insolvency or potential insolvency of Tiger as an Australian company.

(ii) Jurisdiction

In response to IFC's argument that the proposed scheme was not a "compromise or arrangement" within the meaning of s. 411(1) of the Corporations Act, Gleeson J was satisfied on the facts that the proposed Scheme was an "arrangement" in that it involved an adjustment of Tiger's existing obligations under its guarantee by the substantial reduction of the amount of the obligation.

As for the question of classes, her Honour gave her preliminary view that the Tranche A creditors did not form a separate class from the Tranche D and Tranche E creditors (citing numerous cases, including *In the matter of Boart Longyear Ltd* [2017] NSWSC 567, where it was noted a number of matters were directly applicable to the facts of this case). However, her Honour noted that it was not necessary for her to reach a final conclusion on this matter to be satisfied of jurisdiction to order the convening of the scheme meeting. Further, she was not persuaded that the position was so clear that it would be inappropriate to leave this question for final determination at the second court hearing in the circumstances where additional costs would be minimal, given the small number of Scheme creditors.

6.5 Meetings, motions and material personal interests

(By Davina Khoo, DLA Piper)

Anglo Australian Resources NL v Bloom Financial Advice Pty Ltd [2019] WASC 470 (23 December 2019) Supreme Court of Western Australia, Hill J

(a) Summary

The plaintiff, Anglo Australian Resources NL (Anglo Australian), brought proceedings under s. 1325A of the Corporations Act 2001 No. 50 (Cth) (the Corporations Act). The plaintiff alleged that the defendants, 32 individuals and corporations including Bloom Financial Advice Pty Ltd, had contravened ss. 617B and 606 of the Corporations Act by reason of their association within the meaning of s. 12 of the Corporations Act. Remedial orders were sought. Proceedings were stayed until further order, and the application to join another director as a second plaintiff was dismissed.

(b) Facts

The plaintiff received a notice of meeting on 29 October 2019 from the fifth defendant. An extraordinary general meeting was scheduled to be held on 20 December 2019. Three motions were to be considered at the Extraordinary General Meeting (EGM): removal of Graeme Smith as director, removal of John Jones as director, and appointment of David Willis as director. In response, the plaintiff tried to convene an EGM of its shareholders, dispatching a notice of meeting on 19 November 2019. The notice set out statements from John Jones and Graeme Smith as to why shareholders should vote against the proposed resolutions. Peter Stern submitted reasons why the shareholders should vote in favour of the resolutions. From 1 November 2019, the directors of the plaintiff changed numerous times. From 1 November 2019 to 26 November 2019, the directors were Jones, Smith and Stern. The plaintiff sought interlocutory orders that the time limited to hold the general meeting by s. 249D(5) of the Corporations Act be extended until further order, or in the alternative, that the defendants be restrained from voting at the general meeting.

Smith provided evidence that from 8 November 2019, he discussed with Jones the need "to ensure that the Act was fully complied with", referencing Stern's potential material personal interest in the subject matter of the meeting. Smith did not consider that he himself had a material personal interest.

On 27 November 2019, David Sanders of Bennett & Co was appointed director of the plaintiff so that he could chair an Annual General Meeting (AGM) on 28 November 2019. The AGM considered five resolutions, however the only successful resolution was the re-election of Smith as a director. Sanders resigned as director on 28 November 2019, and David Varcoe was appointed in his place.

On 6 December 2019, the first defendant requested that the plaintiff's interlocutory application be listed for mention. Hill J made orders for the filing and serving of affidavits and submission by the parties, including an affidavit from the plaintiff evincing "any decision or authorisation on the part of the Plaintiff with respect to the commencement of the proceedings". Accordingly, the plaintiff filed a third affidavit of Graeme Ian Smith. The interlocutory application was otherwise adjourned for hearing on 13 December 2019.

On 11 December 2019, the second, third, and fourth defendants filed an interlocutory application seeking declaratory relief and orders for the dismissal of proceedings, or a stay in the alternative. These defendants contended that proceedings had commenced without proper authority. An affidavit from Peter Stern was filed in support of the defendants' application, which was listed for 12 December 2019. However, prior to the hearing, the plaintiff filed a further interlocutory application seeking orders for the joining of John Jones as second plaintiff. The application was filed by Bennett & Co as solicitors for the proposed second plaintiff. The plaintiff also filed a fifth affidavit of Graeme Smith sworn on 12 December 2019, attesting to events that occurred in respect of the authority of Bennett & Co to act on behalf of the plaintiff in these proceedings. Hill J made orders staying the proceedings until further order of the Court. His Honour also dismissed the interlocutory process filed on behalf of the proposed second plaintiff.

On 12 December 2019, Smith, Jones and Varcoe met. Varcoe stated that, even if the resolutions for the removal of Jones and Varcoe as directors of Anglo Australian meant that they had a material personal interest in deciding to commence proceedings, he was still prepared for Smith and Jones to be present and vote at the meeting on a resolution to ratify Varcoe's and Jones' decision to commence the proceedings. The ratification of proceedings was unanimously carried when put to a vote, with all three men voting in favour of the resolution. However, Stern was not given notice of the meeting. Under the plaintiff's Constitution, meetings of directors may be convened by a director or company secretary without any timeframe requirements, and quorum is the greater of half of the total number of directors in office, or two. Under the constitution, "a quorum is present at a meeting of the directors during the consideration of the matter only if at least two directors entitled to vote on any motion that may be moved at the meeting in relation to that matter are present". Article 12.26 of the Constitution governs the validity of acts of directors, providing that meetings of directors are valid as if the relevant person had been duly appointed or had duly continued in office and was qualified and entitled to vote, so long as there was no defect in the appointment or continuance in office of a person as a director or of the person so acting; or a person acting as a director was disqualified or was not entitled to vote.

The defendants objected to the meeting authorising Bennet & Co to commence proceedings, as follows:

- it was not a directors' meeting of the plaintiff;
- the second defendant did not receive notice of the meeting; and
- Smith and Jones have a material personal interest in the matters and could not vote on any resolution to authorise commencement of proceedings.

The plaintiff disputed that there was any requirement to provide notice to the second defendant of the meeting, as the only business conducted was a resolution on which the second defendant could not vote.

On 12 December 2019, Jones filed an application to be joined to the proceedings as a second plaintiff, on the grounds that he is a shareholder of the plaintiff.

(c) Decision

Hill J held that proceedings be stayed until further order, and dismissed the application to join another director as a second plaintiff.

Hill J found that each director was entitled to notice of a directors' meeting. There was no contrary provision in the plaintiff's Constitution. Failure to provide notice of the meeting invalidated the meeting, as opposed to being a mere procedural irregularity. His Honour also found that Smith and Jones had a material personal interest in holding an EGM to consider resolutions for their removal. As such, they did not have authority to appoint Bennett & Co as the company's solicitors, or to authorise the commencement of the proceedings on behalf of the plaintiff. In finding that Smith and Jones had a material personal interest in resisting their removal as directors, Hill J cited the decision of Barrett J in *Drillsearch Energy Ltd v McKerlie* [2009] NSWSC 517. In that case, his Honour held that "each of the [directors] has an obvious personal interest in resisting attempts to obtain a resolution of shareholders unseating him - the more so since a decision to remove could legitimately be regarded as an endorsement of the adverse criticisms that have been circulated". Barrett J also considered the nature and operation of "material", referring to *McGellin v Mount King Mining NL* (1998) 144 FLR 228. In that case, Murray J took "material" to mean an interest involving "a relationship of some real substance to the matter under consideration or the contract or arrangement which is proposed", having the "capacity to influence the vote of the particular director upon the decision to be made, bearing in mind that both the article and the section are concerned with that aspect of a director's fiduciary duties which relates to the resolution of conflict of interest which must, of itself, be of a real or substantial kind".

Due to the capacity to influence the vote of a director in relation to a decision to adjourn or otherwise postpone the meeting, neither Smith, Jones, nor Stern could participate in any decision concerning the general meeting of the company. Accordingly, Hill J found the decision by Smith and Jones to instruct Bennett & Co to commence proceedings was a contravention of their statutory duties under s. 195 of the Corporations Act. The material personal interest of Smith and Jones rendered there only one voting director at the 12 December 2019 meeting - Varcoe. No quorum was made thus no valid resolutions were passed. On this ground, the Court ordered a stay of the proceedings.

Hill J accepted that Jones had standing to commence proceedings pursuant to s. 1325A of the Corporations Act. However, his Honour held that Bennett & Co could not act for both the plaintiff and Jones due to his material personal interest in the outcome of the general meeting. His Honour noted the conflict "in acting for both the company and one of its directors". Since plaintiffs cannot be separately represented as a rule of practice, Hill J dismissed the application to join Jones as a plaintiff.

6.6 Do shareholders' agreements prevail over the replaceable rules?

(By Stephanie Daveson and Maggie Skow, Clayton Utz)

Eastone Mining Pty Ltd v Eastone Holding Pty Ltd [2019] NSWSC 1850 (19 December 2019)
Supreme Court of New South Wales, Rees J

(a) Summary

The Supreme Court of New South Wales (the Court) has shed light on the relationship between the replaceable rules in the Corporations Act 2001 No. 50 (Cth) (the Corporations Act) and a joint venture shareholders' agreement, in circumstances where a company had not adopted a constitution. The company and its shareholders were party to an agreement which provided for a shareholder to appoint and remove a director nominated by them to the Board of the company. It was held that the purported removal of that nominee director by the other directors was invalid, as would be any attempt by the remaining shareholders to remove that nominee director under s. 203C of the Corporations Act. The agreement bound all shareholders to conduct the business of the company in accordance with it and, if it is silent on a particular subject, then reference is to be made to the replaceable rules in the Corporations Act or the general law. Resolutions passed at meetings cannot endeavour to produce a result contrary to the agreement.

(b) Facts

The first defendant, Eastone Holding Pty Ltd (Eastone Holding) held mining tenements in Western Australia for the purpose of jade mining exploration. Eastone Holding was in need of funds to progress towards making the mine operational.

In 2017, Mr Tao approached Eastone Holding in relation to investing in the mine. In order to facilitate the investment, Mr Tao incorporated a new company called Eastone Mining Pty Ltd (Eastone Mining). An "Investment and Joint Venture Agreement" (the Agreement) was prepared, under which Eastone Mining agreed to subscribe for shares in Eastone Holding for $250,000, which gave Eastone Mining an 11% interest in Eastone Holding as well as the prospect of further investment in the future. The remaining shares were held by Jade City Holding Limited (Jade City).

The Agreement provided that Eastone Mining was entitled to appoint one director (EOM Director) to the Board of Eastone Holding (the Board) and to appoint one manager to Eastone Holding, and to remove or substitute that director or manager for another, and that the quorum for a meeting of the Board is two directors, of which one must be the EOM Director. Following entry into the Agreement, Mr Tao was appointed as the EOM Director and manager.

Within one year of entering into the agreement problems began to emerge and Mr Tao had a falling out with the other directors of Eastone Holding in relation to whether the invested funds could be used to clear pre-existing debts of Eastone Holding. The relationship never progressed beyond this point with various other further disagreements occurring.

On the evening of Friday 11 January 2019, a notice of urgent meeting of directors was sent to Mr Tao calling a directors meeting for 9pm Perth time on 16 January 2019 to occur via WeChat, at which resolutions were proposed to change the company's directors. On Monday 14 January 2019, Mr Tao stated that the short notice for calling of the meeting was unreasonable, that he was unavailable at that time and that he did not consent to the use of technology to hold the meeting. There were other communications about the meeting, with attempts being made by a director to reschedule it. Mr Tao maintained his objection to the meeting being held and complained that the notice given was too short.

The meeting took place in any event while Mr Tao was absent. The directors present at the meeting passed a resolution that removed Mr Tao as a director of the company. The resolution was said to be validly passed because Mr Tao had deliberately and wilfully not attended in order to vitiate the meeting and endanger the functioning of the company.

A notice of meeting of shareholders was later issued on 24 January 2019 for a meeting to be held on 31 January 2019 to approve the minutes of the directors' meeting of 16 January 2019 and terminate the Agreement and then another was issued on 29 January 2019 for a meeting on 15 March 2019 for the same purpose.

Eastone Mining commenced proceedings against Eastone Holding and the other directors of Eastone Holding. It sought declarations that:

- the 16 January 2019 meeting was not validly convened and that all business transacted at the meeting, including the resolution to remove Mr Tao as a director was null and void and of no effect;
- an order restraining the directors of Eastone Holding from convening another directors' meeting, without the quorum required under the Agreement;
- an order restraining the directors of Eastone Holding from convening a meeting to remove the EOM Director; and

- an order requiring the defendant to take all necessary steps with ASIC to have Mr Tao reinstated as a director of the company.

(c) Decision

(i) Effect of the Agreement

According to the Court, an agreement of this nature can potentially regulate virtually every aspect of internal management within the company, so as to exclude or restrict the operation of the principle of majority rule and most of the other accepted fundamentals of corporate governance and it can amend a company's constitution, being effective as a "resolution of the members" (*Re Duomatic* [1969] 2 Ch 365; [1969] 1 All ER 161). In this case, the Agreement referred to a constitution, although there was no evidence that one existed. Rees J held that it may be that the Agreement stood as the company's constitution, as it was adopted unanimously by the members and thereby displaced or modified the replaceable rules.

In any event, the framework for decision-making was now in the Agreement which amended Eastone Holding's constitution, if indeed it had one. In this case, where it did not have a constitution, the provisions of the Agreement prevailed over the replaceable rules in respect of the conduct of the management of the company.

(ii) Removal of director

The directors did not have the power to remove a director under the Agreement. Although the replacement rule in s. 203C of the Corporations Act provides that the power to remove a director from office is given to the shareholders in general meeting, Rees J held that directors could only be removed in accordance with the Agreement, which in this case only allowed Eastern Mining to remove the director appointed by it.

(iii) Conduct of meetings

Rees J held the Agreement modified the replaceable rule in s. 248F of the Corporations Act (which requires two directors to be present at meetings of directors), and required a quorum of two directors, one of which must be an EOM Director.

She held that it was not necessary to consider whether the amount of notice amounted to reasonable notice to Mr Tao or whether he could be taken as having consented to holding a meeting using technology, as assuming that all of those requirements had been complied with, the directors attending the meeting on 16 January 2019 did not have the power to remove the EOM Director.

The 24 January 2019 notice of meeting sought to call a meeting of shareholders, which, under the replaceable rules, had the power to remove a director. The court stated that approving the minutes of directors' meeting may cure the ultra vires quality of the resolutions made by directors, but not the fact that removal of the EOM Director was in breach of the Agreement. The same issues would also arise in the case of the 29 January 2019 meeting.

In this case, Rees J held that it was not reasonable to hold a meeting of members in Beijing, particularly in the circumstances where the members of the Company are in dispute. However, it was noted it may be reasonable to do so in certain circumstances.

6.7 UK High Court confirms Bitcoins are property

(By James Atcheson, King & Wood Mallesons)

AA v Persons Unknown & Ors, Re Bitcoin [2020] 4 WLR 35; [2019] EWHC 3556 (Comm) (13 December 2019) England and Wales High Court of Justice, Commercial Court, Bryan J

(a) Summary

A hacker, the first defendant, encrypted the systems of a company (Insured Company) who had cybersecurity insurance with an insurance company (Insurer). The Insurer arranged for the payment of Bitcoins to the hacker in exchange for software to decrypt the Insured Company's systems. The Insurer tracked some of the Bitcoins to an account operated by the second defendant which was linked to an exchange operated by the third and fourth defendants.

The Insurer sought an interim proprietary injunction over the 96 Bitcoins against the four defendants. It also asked for the hearing to be heard in private and for alternative service to be permitted.

Bryan J found that Bitcoin is property and accordingly awarded an interim proprietary injunction over the 96 Bitcoins. His Honour further granted a private hearing and permitted alternative service noting how the ability of Bitcoin to be quickly dissipated weighed in favour of both.

(b) Facts

The first defendant encrypted the Insured Company's systems and then demanded US$950,000 in Bitcoin for the decryption software. As the Insured Company was insured against cybercrime attacks, the Insurer arranged payment of 109.25 Bitcoins on the Insured Company's behalf. The Insurer tracked 96 of the Bitcoins to the second defendant's account which is linked to Bitfinex, an exchange operated by the third and fourth defendants. The Insurer could not identify the first and second defendants; however, the second defendant's identity is likely known by the third and fourth defendants because of anti-money laundering requirements.

The Insurer sought a proprietary injunction over the 96 Bitcoins against all four defendants.

The Insurer also sought a private hearing and alternative service.

(c) Decision

- a proprietary injunction over the 96 Bitcoins was granted against all four defendants;
- a private hearing was granted; and
- alternative service was granted.

(i) Proprietary injunction

A proprietary injunction requires property. Traditionally, for something to be property it has had to be either a chose in possession or a chose in action. Bitcoin does not fall into either of those categories because it does not have a right capable of being enforced by action nor is it tangible. Bryan J highlighted that the UK Jurisdictional Task Force's Legal Statement on Crypto Assets and Smart Contracts found that intangibles can still be property even if they are not a chose in action. His Honour found that this accurately reflects English law. As such, Bryan J then went on to find that crypto currency meets the four criteria of property as per *National Provincial Bank v Ainsworth* [1965] 1 AC 1175 in that it is:

- definable;
- identifiable by third parties;
- capable in their nature of assumption by third parties; and
- has a degree of permanence.

Accordingly, Bryan J found that crypto currencies are a form of property for the purposes of a proprietary injunction. Consequently, as there was a serious issue to be tried, the balance of convenience lay in favour of granting the relief and damages would not have been an adequate remedy, Bryan J ordered an interim proprietary injunction.

(ii) Private hearing

Bryan J also allowed for the hearing to be heard in private. His Honour found that this was necessary because there were risks of further attacks on both the Insurer and the Insured Company, there was confidential information in the hearing and the first and second defendants had not had a chance to respond. Additionally, Bryan J noted the ease in which Bitcoin can be dissipated and found that this also weighed in favour of having a private hearing (ie because the first and second defendants could move the Bitcoins if they were informed of the hearing).

(iii) Alternative service

Bryan J also granted alternative service by email on the third and fourth defendants because of the nature of Bitcoin. His Honour found that because Bitcoin can be dissipated from the account at the click of a mouse, it is necessary that service is effected as quickly as possible, which in this case would be by email.

6.8 Exercising a casting vote pursuant to s. 75-115 of the Insolvency Practice Rules

(By Belinda Pinnow, MinterEllison)

Glenfyne International Holding Limited v Glenfyne Farms International AU Pty Ltd (in liq) [2019] NSWCA 304 *(*11 December 2019) Court of Appeal, Supreme Court of New South Wales, Bathurst CJ, Bell P and Macfarlan JA

(a) Summary

This case related to the exercise of a casting vote under s. 75-115 of the Insolvency Practice Rules (Corporations) 2016 (Cth) (the IP Rules) against a resolution to appoint joint liquidators to Glenfyne Farms International AU Pty Ltd (Glenfyne Farms) by its external administrator Mr Gladman (Mr Gladman), who was presiding at the second creditors' meeting. The primary judge found that Mr Gladman was precluded from exercising his casting vote by virtue of s. 75-115 of the IP Rules and thus, the Court did not have the power pursuant to s. 75-43 of the Insolvency Practice Schedule (Corporations) (the Insolvency Practice Schedule), Schedule 2 to the Corporations Act 2001 No. 50 (Cth) (the Corporations Act) to order that the relevant resolution to appoint the joint liquidators had been passed.

On appeal, the Court found that s. 75-115 of the IP Rules empower the "person presiding at the meeting" to exercise a casting vote where the resolution does not relate to "the removal of the external administrator of the company", with subsection (5) taking away the power to exercise a casting vote against such a resolution from the company's external administrator only. Here, the relevant resolution was for the appointment of joint liquidators and not the removal of the external administrator. Further, at the relevant time Mr Gladman had ceased to be the external administrator of Glenfyne Farms. Accordingly, the Court was empowered to make an order that the resolution to appoint the joint liquidators had been passed.

(b) Facts

The appeal related to the failed attempt by Glenfyne International Holding Limited (Glenfyne International) to have its preferred liquidators appointed as joint liquidators of Glenfyne Farms at a second meeting of creditors of Glenfyne Farms. The second creditors' meeting had been convened by the then voluntary administrator of Glenfyne Farms, Mr Gladman. After a vote was passed to place Glenfyne Farms into liquidation (First Resolution), a resolution (Resolution) to appoint Messrs Porter and Micheletto as joint liquidators (Proposed Liquidators) was put. A result was not reached on a poll being taken.

Mr Gladman, as the person presiding at the meeting, exercised the casting vote provided to him by virtue of s. 75-115 of IP Rules to vote against the Resolution, after which Mr Gladman became the liquidator of Glenfyne Farms by virtue of the operation of s. 499(2A) of the Corporations Act.

Glenfyne International sought orders from the Supreme Court of New South Wales that the Resolution be taken to have been passed at the meeting to enable the appointment of the Proposed Liquidators. The principal issues on appeal were:

- whether the primary judge erred in finding that s. 75-115 of the IP Rules prevented Mr Gladman from exercising his casting vote against the resolution (First Appeal Ground);
- whether the primary judge erred in holding that the Court did not have the power to make an order pursuant to s. 75-43 of the Insolvency Practice Schedule (Second Appeal Ground); and
- whether the Court's power under s. 90-15 of the Insolvency Practice Schedule to make such orders as it thinks fit in relation to the external administration of a company depended, for its exercise, on whether a liquidator or external administrator had failed in the exercise of his or her duties (Third Appeal Ground).

Relevantly, on the same day as the primary proceedings were filed, Glenfyne International Limited also commenced proceedings against GI Commercial Pty Ltd (GI Commercial) seeking an order that GI Commercial be wound up and that the Proposed Liquidators also be appointed to GI Commercial as joint and several liquidators. It was common ground in both proceedings (which were heard together) that the same liquidators should be appointed to both Glenfyne Farms and GI Commercial.

(c) Decision

The Court held that the appeal should be allowed, finding in relation to the First Appeal Ground that the primary judge had erred in finding that s. 75-115 of the IP Rules prevented Mr Gladman from exercising his casting vote against the resolution. The Court found that this section only applied to resolutions relating to the "removal of the external administrator of the company", whereas the Resolution was for the appointment of joint liquidators.

Further, the Court relevantly noted that:

- s. 75-115(3) of the IP Rules empowers the "person presiding at the meeting" to exercise a casting vote where the resolution does not relate to the removal of the external administrator of the company, with subsection (5) taking away the power to exercise a casting vote against such a resolution from the external administrator only;
- the administration of Glenfyne Farms had ended after the First Resolution was passed at the meeting, thus the administrator's position expired prior to the Resolution being put; and
- Mr Gladman exercised his casting vote in his capacity as the person presiding over the meeting and not in his capacity as external administrator.

In relation to the Second Appeal Ground, the Court found that the primary judge erred in finding that s. 75-43 of the Insolvency Practice Schedule was not engaged. As the casting vote was the cause of the Resolution not being passed, s. 75-43 of the Insolvency Practice Schedule relevantly applied, and the Court was empowered to make orders under s. 75-43(4)(a) of the Insolvency Practice Schedule to order that the Resolution be taken to have been passed. In the circumstances, the Court considered it appropriate to make such an order.

While consideration of the Third Appeal Ground was not strictly necessary following the findings relating to the First Appeal Ground and the Second Appeal Ground, the Court considered, among others, the matters of *Borg v de Vries (Trustee), in the matter of the Bankrupt Estate of David Morton Bertram* [2018] FCA 2116, and in the matter of *Manband Pty Limited (in liquidation) (subject to a Deed of Company Arrangement)* [2018] NSWSC 1282, and ultimately disagreed with the primary judge's view that s. 90-15 of the Insolvency Practice Schedule requires some failure on the part of the external administrator to attend to his or her duties in order for the power contained in that subsection to be engaged (though it was noted where such a failure occurs, it may be that there is a stronger case for the Court to exercise the power afforded to it under s. 90-15 of the Insolvency Practice Schedule).
