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[Recent Corporate Law and Corporate Governance Developments](http://www.law.unimelb.edu.au/bulletins/152%20April%202010.htm#h1) 2. [Recent ASIC Developments](http://www.law.unimelb.edu.au/bulletins/152%20April%202010.htm#h2) 3. [Recent ASX Developments](http://www.law.unimelb.edu.au/bulletins/152%20April%202010.htm#h3) 4. [Recent Takeovers Panel Developments](http://www.law.unimelb.edu.au/bulletins/152%20April%202010.htm#h4) 5. [Recent Corporate Law Decisions](http://www.law.unimelb.edu.au/bulletins/152%20April%202010.htm#h5) 6. [Contributions](http://www.law.unimelb.edu.au/bulletins/152%20April%202010.htm#6) 7. [Previous editions of the Corporate Law Bulletin](http://my.lawlex.com.au/default.asp?goto=previous_news&indexid=7" \t "_new) | | [eview my Newsfeed selections](http://my.lawlex.com.au/default.asp?goto=news_sub) [iew past editions of Newsfeeds](http://my.lawlex.com.au/default.asp?goto=news) [iew a list of related Standards](http://infostore.saiglobal.com/store/results2.aspx?searchType=subject&publisher=All&doctype=All&status=Current&sfld1=ICS%20Code&sval1=03.160) [earch all Australian legislation from one website](http://my.lawlex.com.au/default.asp?goto=search_leg) [ree trial our Lawlex Legislative Alerts](http://www.saiglobal.com/Compliance/regulatory-news/asiapac/lawlex-legislative-alert.htm) [ree trial our other regulatory products and services](http://www.saiglobal.com/compliance/regulatory-news/default.htm) [overnance, risk and compliance solutions](http://www.saiglobal.com/compliance/about/) | | |  | | --- | | COPYRIGHT WARNING Use of this product must be in accordance with our licence agreement and the relevant licence fee paid by your organisation. We will vigorously pursue legal action against organisations found to be in breach of these requirements, in particular where email content has been forwarded, copied or pasted in any way without prior authorisation. If you are uncertain about your organisation's licensing arrangements, please contact SAI Global on 1300 555 595. | |  | |  |  |  |  |  |  | | --- | --- | --- | --- | --- | | |  |  |  | | --- | --- | --- | | |  |  | | --- | --- | | **Detailed Contents** | [own](http://www.law.unimelb.edu.au/bulletins/152%20April%202010.htm%231) | | | http://my.lawlex.com.au/alert/pic/spacer.gif | | | [1. Recent Corporate Law and Corporate Governance Developments](http://www.law.unimelb.edu.au/bulletins/152%20April%202010.htm#1)  [1.1 Superannuation system review releases preliminary reports](http://www.law.unimelb.edu.au/bulletins/152%20April%202010.htm#011) [1.2 Government responds to the Productivity Commission report on executive remuneration](http://www.law.unimelb.edu.au/bulletins/152%20April%202010.htm#012) [1.3 SEC charges Goldman Sachs with fraud in structuring and marketing of CDO tied to subprime mortgages](http://www.law.unimelb.edu.au/bulletins/152%20April%202010.htm#013) [1.4 SEC proposes new measures to protect investors in options markets](http://www.law.unimelb.edu.au/bulletins/152%20April%202010.htm#014) [1.5 SEC proposes large trader reporting system](http://www.law.unimelb.edu.au/bulletins/152%20April%202010.htm#015) [1.6 CESR begins the process to overhaul MiFID by consulting on policy options](http://www.law.unimelb.edu.au/bulletins/152%20April%202010.htm#016) [1.7 ECB signals a gradual recovery of the European financial integration process](http://www.law.unimelb.edu.au/bulletins/152%20April%202010.htm#017) [1.8 IAIS responds to regulatory gaps with guidance on treatment of non-regulated entities](http://www.law.unimelb.edu.au/bulletins/152%20April%202010.htm#018) [1.9 Report into the financial collapse in Iceland](http://www.law.unimelb.edu.au/bulletins/152%20April%202010.htm#019) [1.10 Canadian securities regulators issue proposals to improve issuer communications with investors](http://www.law.unimelb.edu.au/bulletins/152%20April%202010.htm#0110) [1.11 IOSCO publishes disclosure principles for public offerings and listings of asset backed securities](http://www.law.unimelb.edu.au/bulletins/152%20April%202010.htm#0111) [1.12 Report on Islamic finance](http://www.law.unimelb.edu.au/bulletins/152%20April%202010.htm#0112) [1.13 SEC proposes rules to increase investor protections in asset-backed securities](http://www.law.unimelb.edu.au/bulletins/152%20April%202010.htm#0113) [1.14 CEBS publishes draft guidelines on joint assessment and joint decision regarding the capital adequacy of cross border groups](http://www.law.unimelb.edu.au/bulletins/152%20April%202010.htm#0114) [1.15 Market Abuse Directive - CESR reviews options and discretions](http://www.law.unimelb.edu.au/bulletins/152%20April%202010.htm#0115) [1.16 Report on UK shareholder voting on governance issues](http://www.law.unimelb.edu.au/bulletins/152%20April%202010.htm#0116) [1.17 IMF global financial stability report](http://www.law.unimelb.edu.au/bulletins/152%20April%202010.htm#0117) [1.18 Study of securities class actions in the US for 2009](http://www.law.unimelb.edu.au/bulletins/152%20April%202010.htm#0118) [1.19 House of Lords report on future regulation of derivatives markets](http://www.law.unimelb.edu.au/bulletins/152%20April%202010.htm#0119) [1.20 Removal of large deposits and wholesale funding guarantee for Australian financial institutions](http://www.law.unimelb.edu.au/bulletins/152%20April%202010.htm#0120)  [1.21 Australian government announces in principle approval of new entrant in financial markets trade execution service](http://www.law.unimelb.edu.au/bulletins/152%20April%202010.htm#0121) [1.22 Report on building high performance boards](http://www.law.unimelb.edu.au/bulletins/152%20April%202010.htm#0122)  [1.23 Hong Kong consultation on draft guidelines on disclosure of inside information](http://www.law.unimelb.edu.au/bulletins/152%20April%202010.htm#0123) [1.24 US director remuneration survey](http://www.law.unimelb.edu.au/bulletins/152%20April%202010.htm#0124) [1.25 FSA publishes rules on adviser charging](http://www.law.unimelb.edu.au/bulletins/152%20April%202010.htm#0125) [1.26 Report on lessons distilled from funding market disruptions](http://www.law.unimelb.edu.au/bulletins/152%20April%202010.htm#0126) [1.27 SEC staff evaluating the use of derivatives by funds](http://www.law.unimelb.edu.au/bulletins/152%20April%202010.htm#0127) [1.28 APRA consults on proposals for the supervision of conglomerate groups](http://www.law.unimelb.edu.au/bulletins/152%20April%202010.htm#0128) [1.29 Recommendations for strengthening cross-border bank resolution frameworks - final paper issued by Basel Committee](http://www.law.unimelb.edu.au/bulletins/152%20April%202010.htm#0129) [1.30 Proposed enhancements to Singapore corporate governance framework](http://www.law.unimelb.edu.au/bulletins/152%20April%202010.htm#0130)  [1.31 Disclosure guide for private equity](http://www.law.unimelb.edu.au/bulletins/152%20April%202010.htm#0131) [1.32 Principles for enhancing corporate governance issued by Basel Committee](http://www.law.unimelb.edu.au/bulletins/152%20April%202010.htm#0132) [1.33 CalPERS seeks majority vote standard at top publicly traded companies](http://www.law.unimelb.edu.au/bulletins/152%20April%202010.htm#0133) [1.34 Corporate governance guidance and principles for unlisted companies in Europe](http://www.law.unimelb.edu.au/bulletins/152%20April%202010.htm#0134)  [2. Recent ASIC Developments](http://www.law.unimelb.edu.au/bulletins/152%20April%202010.htm#2)  [2.1 ASIC releases guidance on regulation of clearing and settlement facilities](http://www.law.unimelb.edu.au/bulletins/152%20April%202010.htm#021) [2.2 ASIC consults to improve disclosure by infrastructure entities](http://www.law.unimelb.edu.au/bulletins/152%20April%202010.htm#022) [2.3 ASIC consults to improve agribusiness scheme disclosure](http://www.law.unimelb.edu.au/bulletins/152%20April%202010.htm#023) [2.4 Registration opens for licensees under the new national consumer credit regime](http://www.law.unimelb.edu.au/bulletins/152%20April%202010.htm#024) [2.5 Guidance for credit licensees about compensation and insurance obligations](http://www.law.unimelb.edu.au/bulletins/152%20April%202010.htm#025)  [3. Recent ASX Developments](http://www.law.unimelb.edu.au/bulletins/152%20April%202010.htm#3)  [3.1 Reports](http://www.law.unimelb.edu.au/bulletins/152%20April%202010.htm#031) [3.2 Restructure of the ASX and SFE operating rules](http://www.law.unimelb.edu.au/bulletins/152%20April%202010.htm#032) [3.3 ASX submission to ASIC consultation paper 131](http://www.law.unimelb.edu.au/bulletins/152%20April%202010.htm#033)  [4. Recent Takeovers Panel Developments](http://www.law.unimelb.edu.au/bulletins/152%20April%202010.htm#4)  [4.1 Panel publishes consultation paper](http://www.law.unimelb.edu.au/bulletins/152%20April%202010.htm#041) [4.2 Panel publishes revised Procedural Rules](http://www.law.unimelb.edu.au/bulletins/152%20April%202010.htm#042)  [5. Recent Corporate Law Decisions](http://www.law.unimelb.edu.au/bulletins/152%20April%202010.htm#5)  [5.1 Deed of company arrangement - power of a court to set aside](http://www.law.unimelb.edu.au/bulletins/152%20April%202010.htm#051) [5.2 Requirements of summonses to produce documents issued under section 596B of the Corporations Act](http://www.law.unimelb.edu.au/bulletins/152%20April%202010.htm#052) [5.3 When is a creditor a shadow director of its debtor?](http://www.law.unimelb.edu.au/bulletins/152%20April%202010.htm#053) [5.4 Penalties for director drafting and authorising misleading and deceptive statements made to the ASX](http://www.law.unimelb.edu.au/bulletins/152%20April%202010.htm#054) [5.5 Reading down of an aggressive takeover defence fee arrangement](http://www.law.unimelb.edu.au/bulletins/152%20April%202010.htm#055) [5.6 Commencing proceedings against a company in liquidation and access to inspect its books](http://www.law.unimelb.edu.au/bulletins/152%20April%202010.htm#056) [5.7 The court's role in granting orders to convene shareholders' meetings for a proposed scheme of arrangement](http://www.law.unimelb.edu.au/bulletins/152%20April%202010.htm#057) [5.8 The application of section 253E to custodians and the construction of 'business relationship' in section 16(1)(a) of the Corporations Act](http://www.law.unimelb.edu.au/bulletins/152%20April%202010.htm#058) [5.9 Court order under section 447A of the Corporations Act can be made with reference to a Part of the Act and/or Regulations in the Act](http://www.law.unimelb.edu.au/bulletins/152%20April%202010.htm#059) [5.10 Oppression and winding-up: when is a broken relationship not enough?](http://www.law.unimelb.edu.au/bulletins/152%20April%202010.htm#0510) [5.11 Requirements for necessary intention to create a Quistclose trust](http://www.law.unimelb.edu.au/bulletins/152%20April%202010.htm#0511) [5.12 Directors' duties: Determining whether a director's actions are "reasonable"](http://www.law.unimelb.edu.au/bulletins/152%20April%202010.htm#0512) [5.13 Determining share value for purposes of buy out order](http://www.law.unimelb.edu.au/bulletins/152%20April%202010.htm#0513) |  |  |  |  |  | | --- | --- | --- | --- | | |  |  |  | | --- | --- | --- | | **1. Recent Corporate Law and Corporate Governance Developments** |  | [ext Section](http://www.law.unimelb.edu.au/bulletins/152%20April%202010.htm%232) | | | http://my.lawlex.com.au/alert/pic/spacer.gif | | |  | | --- | | **1.1 Superannuation system review releases preliminary reports**  The Superannuation System Review has recently published two preliminary reports. On 20 April 2010, the Review released a report titled 'MySuper: Optimising Australian Superannuation'. This preliminary report provides more detail on the choice architecture outlined by the Review Panel in its Phase One preliminary report 'Clearer Super Solutions' released late last year. 'MySuper' is the new name for the universal fund concept proposed in that report.  Some of the proposed features of MySuper include:   * A ban on trailing commissions; * No contribution fees; * A new duty on trustees to manage the overall cost to members; * A default post-retirement product; and * Trustee duties focused entirely on looking after the member.   An independent report commissioned from Deloitte by the Review shows that if the MySuper proposals were introduced, some default fund members could expect to pay less than half what they are paying for their super now.  On 22 March 2010, the Review published 'SuperStream: Bringing the Back Office of Super into the 21st Century', a preliminary report focused on improving the 'back office' of the superannuation system.  Inefficiency in the back office was a key theme raised by submissions in response to the 'Review's Phase Two: Operation and Efficiency' issues paper. To address these problems, the Review Panel proposes a package of measures, collectively called 'SuperStream', which include:   * improving the quality of data when members enter the system using industry-wide standards; * better use of technology, including 'straight-through processing' (ie without human intervention); * e-commerce solutions to replace paper; * extending the use of the tax file number as a primary identifier throughout the system; * easier consolidation of multiple member accounts; and * eliminating redundant processes, leading to simpler rollovers and consolidations.   The Review has completed consultation in three phases: Governance; Operation and Efficiency; and Structure (including SMSFs), and has received over 450 submissions.  The final report (encompassing all three phases) will be delivered to the Government by 30 June 2010.  The reports are available from the [Review](http://www.supersystemreview.gov.au/" \t "_new) website.  [etailed Contents](http://www.law.unimelb.edu.au/bulletins/152%20April%202010.htm%23h1)  **1.2 Government responds to the Productivity Commission report on executive remuneration**  On 16 April 2010, the Australian Government announced its response to the Productivity Commission's (PC's) final report on Australia's director and executive remuneration framework.  The Government supports nearly all of the PC's recommendations and has decided to further strengthen several of the recommendations by expanding their scope and enforceability. The Government will also consider an additional proposal, not identified by the PC, to clawback bonuses paid to directors and executives in the event of a material misstatement in the company's financial statements.  The inquiry was commissioned in March last year and final PC report was released on 4 January 2010.  The recommendations of the PC were summarised in the [January 2010 issue](http://my.lawlex.com.au/news.asp?id=7611&sp=1" \l "0113" \t "_new) of the Corporate Law Bulletin.  The Government response is available on the [Treasury](http://ministers.treasury.gov.au/Ministers/ceba/Content/pressreleases/2010/attachments/033/033.pdf" \t "_new) website.  [etailed Contents](http://www.law.unimelb.edu.au/bulletins/152%20April%202010.htm%23h1)  **1.3 SEC charges Goldman Sachs with fraud in structuring and marketing of CDO tied to subprime mortgages**  On 16 April 2010, the US Securities and Exchange Commission charged Goldman, Sachs & Co and one of its vice presidents with defrauding investors by misstating and omitting key facts about a financial product tied to subprime mortgages as the US housing market was beginning to falter.  The SEC alleges that Goldman Sachs structured and marketed a synthetic collateralized debt obligation (CDO) that hinged on the performance of subprime residential mortgage-backed securities (RMBS). Goldman Sachs failed to disclose to investors vital information about the CDO, in particular the role that a major hedge fund played in the portfolio selection process and the fact that the hedge fund had taken a short position against the CDO.  The SEC alleges that one of the world's largest hedge funds, Paulson & Co, paid Goldman Sachs to structure a transaction in which Paulson & Co could take short positions against mortgage securities chosen by Paulson & Co based on a belief that the securities would experience credit events.  According to the SEC's complaint, filed in US District Court for the Southern District of New York, the marketing materials for the CDO known as ABACUS 2007-AC1 (ABACUS) all represented that the RMBS portfolio underlying the CDO was selected by ACA Management LLC (ACA), a third party with expertise in analyzing credit risk in RMBS. The SEC alleges that undisclosed in the marketing materials and unbeknownst to investors, the Paulson & Co hedge fund, which was poised to benefit if the RMBS defaulted, played a significant role in selecting which RMBS should make up the portfolio.  The SEC's complaint alleges that after participating in the portfolio selection, Paulson & Co effectively shorted the RMBS portfolio it helped select by entering into credit default swaps (CDS) with Goldman Sachs to buy protection on specific layers of the ABACUS capital structure. Given that financial short interest, Paulson & Co had an economic incentive to select RMBS that it expected to experience credit events in the near future. Goldman Sachs did not disclose Paulson & Co's short position or its role in the collateral selection process in the term sheet, flip book, offering memorandum, or other marketing materials provided to investors.  The SEC alleges that Goldman Sachs Vice President Fabrice Tourre was principally responsible for ABACUS 2007-AC1. Tourre structured the transaction, prepared the marketing materials, and communicated directly with investors. Tourre allegedly knew of Paulson & Co's undisclosed short interest and role in the collateral selection process. In addition, he misled ACA into believing that Paulson & Co invested approximately US$200 million in the equity of ABACUS, indicating that Paulson & Co's interests in the collateral selection process were closely aligned with ACA's interests. In reality, however, their interests were sharply conflicting.  According to the SEC's complaint, the deal closed on 26 April 2007, and Paulson & Co paid Goldman Sachs approximately US$15 million for structuring and marketing ABACUS. By 24 October 2007, 83 percent of the RMBS in the ABACUS portfolio had been downgraded and 17 percent were on negative watch. By 29 January 2008, 99 percent of the portfolio had been downgraded. Investors in the liabilities of ABACUS are alleged to have lost more than US$1 billion.  The SEC's complaint charges Goldman Sachs and Tourre with violations of section 17(a) of the Securities Act of 1933, Section 10(b) of the Securities Exchange Act of 1934, and Exchange Act Rule 10b-5. The Commission seeks injunctive relief, disgorgement of profits, prejudgment interest, and financial penalties.  Further information is available on the [SEC](http://www.sec.gov/" \t "_new) website.  [etailed Contents](http://www.law.unimelb.edu.au/bulletins/152%20April%202010.htm%23h1)  **1.4 SEC proposes new measures to protect investors in options markets**  On 14 April 2010, the US Securities and Exchange Commission (SEC) proposed to put in place two investor protection measures in options markets that currently exist in stock markets.  The SEC's proposal would prohibit an options exchange from unfairly impeding access to displayed quotations, and would limit the fees that an options exchange can charge investors and others wishing to access a quote on an exchange.  The SEC's proposal is designed to extend the same measures to listed options that currently apply only to transactions involving exchange-listed stocks. By expanding the protections that are available in the options markets, the SEC's proposal would help provide investors with the ability to achieve best execution for their orders, and remove barriers that an exchange might erect to keep non-members from accessing a quotation on the exchange.  The proposal is available on the [SEC](http://www.sec.gov/rules/proposed/2010/34-61902.pdf" \t "_new) website.  [etailed Contents](http://www.law.unimelb.edu.au/bulletins/152%20April%202010.htm%23h1)  **1.5 SEC proposes large trader reporting system**  On 14 April 2010, the US Securities and Exchange Commission (SEC) voted to propose the creation of a large trader reporting system that would enhance its ability to identify large market participants, collect information on their trades, and analyze their trading activity.  The SEC is proposing that large traders be required to identify themselves to the Commission, which would then assign each trader a unique identification number. Large traders would provide this number to their broker-dealers, who would be required to maintain transaction records for each large trader and report that information to the SEC upon request.  Under the SEC's proposal, traders who engage in substantial levels of trading activity would be required to identify themselves to the SEC through a filing with the Commission. A "large trader" would be generally defined as a firm or individual whose transactions in exchange-listed securities equal or exceed two million shares or US$20 million during any calendar day, or 20 million shares or US$200 million during any calendar month.  The proposal on large trader reporting system is available on the [SEC](http://www.sec.gov/rules/proposed/2010/34-61908.pdf" \t "_new) website.  [etailed Contents](http://www.law.unimelb.edu.au/bulletins/152%20April%202010.htm%23h1)  **1.6 CESR begins the process to overhaul MiFID by consulting on policy options**  On 13 April 2010, the Committee of Securities Regulators (CESR) published three consultation papers on its technical advice to the Commission. The papers are to be seen in the context of reviewing MiFID, the Markets in Financial Instruments Directive that entered into force in November 2007. The review includes proposed technical advice by CESR on investor protection and intermediaries (Ref. CESR/10-417), equity markets (Ref. CESR/10-394) and transaction reporting (Ref. CESR/10-292). CESR invites stakeholders to comment on all of the three consultation papers by 31 May 2010.  Since MiFID's entry into force, European financial markets have undergone a fundamental restructuring. For instance, markets have seen greater competition and more pan-European trading, the emergence of dark pools, consolidation between exchanges, improvements in trading technology as well as other innovations, such as smart order routing, algorithmic trading and new clearing arrangements.  In its three consultation papers, CESR addresses areas of the MiFID legal framework where it has identified a need for improvement, including quality, cost and consolidation of post-trade transparency data and delays in the publication of such data. Furthermore, with the global financial crisis in the background, regulators have seen a need to focus more on selling practices for certain financial instruments in order to further improve the protection of investors, in particular retail investors.  The draft advice that CESR has published includes policy proposals on investor protection and intermediaries, equity markets and transaction reporting.  **(a) Consultation on investor protection and intermediaries**  The first consultation paper published deals with issues relating to investor protection and intermediaries (Ref. CESR/10-417). CESR's consultation covers six main policy lines:   * Requirements for recording telephone conversations and electronic communications * Execution quality data * Complex vs non-complex financial instruments * Definition of personal recommendation * Supervision of tied agents and related issues * MiFID options and discretions   **(b) Consultation on equity markets**  The second consultation paper deals with equity markets and was developed on the basis of CESR's continued work on the issues identified in its previous report on the impact of MiFID on equity secondary markets functioning (Ref. CESR/09-355). The main topics addressed in this consultation paper are:   * Retaining pre-trade transparency regime for organised markets * Review of definition of and obligations for systematic internalisers * Improving the post-trade transparency regime * Enhancing application of transparency obligations to equity-like instruments * Regulatory framework for consolidation and cost of market data * Addressing regulatory boundaries and requirements * Eliminating certain options and discretions of MiFID   **(c) Consultation on transaction reporting**  The third consultation paper (Ref. CESR/10-292) deals with transaction reporting. The paper sets out CESR's proposal for amending and clarifying the transaction reporting regime under MiFID. The main changes proposed focus on:   * The introduction of a third trading capacity (riskless principal) * Collection of and standards for client and counterparty identifiers * Client ID collection when orders are transmitted for execution * Transaction reporting by market members not authorised as investment firms   Further information is available on the [CESR](http://www.cesr.eu/data/document/10_423.pdf" \t "_new) website.  [etailed Contents](http://www.law.unimelb.edu.au/bulletins/152%20April%202010.htm%23h1)  **1.7 ECB signals a gradual recovery of the European financial integration process**  On 12 April 2010, the European Central Bank (ECB) published its fourth Report on Financial Integration in Europe, which notes the return towards integration in the European financial markets.  The first chapter of the report assesses the state of financial integration in the euro area, based on a set of indicators developed by the ECB. The crisis affected financial markets to very different degrees. The most integrated ones, such as the money markets, showed clear signs of retrenchment within national borders.  The bond and retail banking markets, by contrast, were less affected, and the equity markets did not show any appreciable retreat from cross-border integration. As financial markets gradually returned to more normal conditions in 2009 and 2010, the markets that had suffered most also returned more rapidly towards their pre-crisis integration levels.  The second chapter contains four special features, i.e. in-depth assessments of selected topics:   * banking integration and supervision in the European Union (EU) * covered bonds, a key funding instrument for credit institutions in Europe * harmonisation in the post-trading sector * the stability implications of financial market integration and development   The last chapter of the report provides an overview of the Eurosystem's main activities in the field of financial integration in 2009.  The report is available on the [ECB](http://www.ecb.europa.eu/" \t "_new) website.  [etailed Contents](http://www.law.unimelb.edu.au/bulletins/152%20April%202010.htm%23h1)  **1.8 IAIS responds to regulatory gaps with guidance on treatment of non-regulated entities**  On 12 April 2010, the International Association of Insurance Supervisors (IAIS) published a guidance paper on treatment of non-regulated entities in group-wide supervision to support insurance supervisors worldwide address some of the key regulatory gaps as observed from the global financial crisis and to minimise regulatory arbitrage opportunities.  The guidance paper provides eight key features of group-wide supervision. These features call for appropriate consideration of the complexity of group structures and the full spectrum of risks posed by non-regulated entities through measures such as capital adequacy and governance requirements.  The release of the guidance paper responds to the recommendation by the G20, the Financial Stability Board and the Joint Forum which called for standard setting bodies to review the scope of financial regulation and address any gaps.  The guidance paper is available on the [IAIS](http://www.iaisweb.org/" \t "_new) website.  [etailed Contents](http://www.law.unimelb.edu.au/bulletins/152%20April%202010.htm%23h1)  **1.9 Report into the financial collapse in Iceland**  On 12 April 2010, the report of the Special Investigation Commission (SIC) into the collapse of the Iceland banking system was published. The SIC was established by Icelandic Parliament in December 2008 to investigate and analyse the processes leading to the collapse of the three main banks in Iceland.  It has been said that relative to the size of its economy, Iceland's banking collapse is the largest suffered by any country in economic history. It is generally agreed that the collapse of the Icelandic banking system has been catastrophic for the country leading to a severe recession, significant declines in the country's gross domestic product, in the national currency and in the market capitalisation of the Icelandic stock exchange.  There are, therefore, important lessons to be learnt from the collapse. The following are extracts from the report grouped under headings which the SIC reported as the main causes of the collapse.  **(a) Excessive size of the banks relative to the Icelandic economy**  It is stated in the report that explanations for the collapse of Glitnir Bank hf., Kaupthing Bank hf. and Landsbanki Íslands hf. are first and foremost to be found in their rapid expansion and their subsequent size when they collapsed in October 2008.  Their balance sheets and lending portfolios expanded beyond the capacity of their own infrastructure. Management and supervision did not keep up with the rapid expansion of lending. Growth in lending by the banks' parent companies averaged nearly 50% from the beginning of 2004 until their collapse.  Lending to holding companies grew at the fastest and steadiest pace, on the one hand, and to foreign parties on the other hand. Growth in lending to foreign parties was significantly more rapid. The growth was especially rapid during the latter part of 2007. The banks' rapid lending growth had the effect that their asset portfolios became fraught with high risk.  Access to international financial markets was, for the banks, the principal premise for their big growth. This was especially the case in the years 2004 to 2006. In 2005, Glitnir, Kaupthing Bank and Landsbanki received around EUR 14 billion in foreign debt securities. This amount was slightly higher than Iceland's gross domestic product in that year.  **(b) Wrong incentives for growth**  In general, such large-scale and high-risk growth is not compatible with the long-term interests of solid banks. There were strong incentives for growth within the banks. These incentives included the banks' incentive schemes, as well as the high leverage of the major owners. It should have been clear to the supervisory authorities that such incentives existed and that there was reason for concern over this rapid growth. However, it is evident that the Financial Supervisory Authority (FME), the institution that bore the main responsibility for monitoring the activities of the banks, did not grow in the same proportion as the banks, and its practices did not keep up with the rapid changes in the banks' practices.  **(c) Failure of government to respond to the banks' growth**  When the banking system had become far too big, relative to the size of the Icelandic economy, the governmental authorities needed to respond. No later that 2006 it would have been necessary to take action, if there was to be any chance of preventing the collapse of the banks, without severely impacting upon the value of their assets. Neither that year nor the next did the authorities try, in a decisive way, to have the banks reduce the size of their balance sheets.  It is also clear that when the size of the financial system of a country is, for instance, threefold its gross domestic product, the competent authorities of the country have, in general, the potential to set rules for the financial system to comply with and to ensure compliance with such rules. However, when the size of the financial system of a country is nine times its gross domestic product the roles are reversed. This was the case in Iceland. It appears that both the parliament and the government lacked both the power and the courage to set reasonable limits to the financial system. All the energy seems to have been directed at keeping the financial system going. It had grown so large, that it was impossible to risk that even one part of it would collapse.  **(d) Excessive lending by the banks to their major shareholders**  At Glitnir Bank hf. the largest borrowers were Baugur Group hf and companies affiliated to Baugur. The accelerated pace of Glitnir's growth in lending to this group just after mid-year 2007 is of particular interest. At that time, a new Board of Directors had been elected for Glitnir since parties affiliated with Baugur and FL Group had significantly increased their stake in the bank. When the bank collapsed, its outstanding loans to Baugur and affiliated companies amounted to over ISK 250 billion (a little less than EUR 2 billion). This amount was equal to 70% of the bank's equity base.  When Landsbanki collapsed, Björgólfur Thor Björgólfsson and companies affiliated to him were the bank's largest debtors. Björgólfur Guðmundsson was the bank's third largest debtor. In total, their obligations to the bank amounted to well over ISK 200 billion. This amount was higher than Landsbanki Group's equity.  It seems that the boundaries between the interests of the banks and the interests of their largest shareholders were often fuzzy and that the banks put more emphasis on backing up their owners, thus going beyond normal practices. The operations of the Icelandic banks were, in many ways, characterised by their maximising the interests of the larger shareholders, who managed the banks, rather than running solid banks with the interests of all shareholders in mind.  **(e) The banks invested in their own shares and in the shares of the other banks**  The banks had invested their funds in their own shares. Share capital, financed by the company itself, is not the protection against loss it is intended to be. Here this is referred to as "weak equity". Weak equity in the three banks amounted to about ISK 300 billion by mid year 2008. At the same time, the capital base of the banks was about ISK 1,186 billion in total. Weak equity, therefore, represented more than 25% of the banks' capital base. If only the core component of the capital base is examined, i.e. shareholders' equity, according to the annual accounts, less intangible assets, the weak equity of the three banks amounted to more than 50% of the core component in mid year 2008.  In addition to the risk that the banks carried on account of their own shares, the SIC assessed how much risk they carried from each other's shares. Here this is referred to as "cross-financing". Around mid year 2008, direct financing by the banks of their own shares, as well as cross-financing of the other banks' shares, amounted to about ISK 400 billion. If only the core component of the capital base is examined this amounted to about 70% of the core component in 2008.  **(f) Flawed government policies**  In the last decade, the economic policy of the Icelandic authorities has aimed at maintaining maximum long-term economic growth. It is the opinion of the SIC that neither the state's budget policy nor its monetary policy adequately addressed economic fluctuations, overexpansion and growing imbalance in the economy. Unfortunately, it seems to be unavoidable to conclude that the state's budget policy increased the imbalance. The policy of the CBI was not sufficiently restrictive and its actions too limited to render the desired results in the fight against increased leverage and underlying inflation.  The authorities decided to lower taxes during an economic expansion period. This was done despite expert advice and even against the better judgment of policy makers who made the decision. This decision was highly reproachable.  **(g) Flawed government response to the impending crisis**  The Prime Minister, the Minister for Foreign Affairs and the Minister of Finance met with the Board of Governors of the Central Bank of Iceland (CBI) on 7 February 2008. During the meeting, the Chairman of the Board of Governors painted a very bleak picture of the state and future prospects of the Icelandic banks. The information indicated an imminent danger for the Icelandic economy. The Board of Governors also met with the Prime Minister and the Minister for Foreign Affairs on 1 April 2008. In that meeting, the Board informed the ministers that GBP 193 million had been withdrawn from the Icesave accounts in London during the previous weekend. The Board also said that Landsbanki could withstand such an outflow for six days. Neither the Prime Minister nor other ministers of the government who were informed about this reacted by resorting to active and credible measures.  It has been established that until just before the collapse of the banks there was little discussion within the Icelandic government of the bank's standing and of the liquidity crisis which began towards the end of summer 2007.  On Monday 29 September 2008, it was publicly announced that the Icelandic government would supply Glitnir with EUR 600 million in exchange for a 75% share in the bank. The SIC is of the opinion that it must be strongly criticised how the CBI's Board of Governors conducted the examination and processing of Glitnir's request. The Glitnir request was not processed on sufficient grounds. For the same reason, the CBI's Board of Governors did not have the necessary information to be able to estimate in an adequate manner whether the action proposed by the CBI to the government was rational.  In the end, the actions proposed to the minister concerning Glitnir on Sunday 28 September 2008, were not credible. First of all, the amount in question was nearly a quarter of the CBI's foreign currency reserves. Secondly, Glitnir had encountered difficulties concerning financing in foreign markets for about a year. At the same time, the bank was aware that liabilities amounting to EUR 1.4 billion would fall due in the coming six months. This was public information. Thirdly, the CBI had not managed to strengthen its foreign currency reserves in any significant manner despite its declarations of intending to do so. To foreign investors and credit-rating agencies it must have seemed evident that the Icelandic state did not have access to financing markets either.  **(h) Inadequacies by the regulator**  The Financial Supervisory Authority (FME) was not well enough equipped to sufficiently monitor the financial institutions when they collapsed in the autumn of 2008. Considering the operating expenses of the FME and its budget up to 2006, it is clear that the growth of the Authority did not keep pace with the rapid growth of the Icelandic financial system, more complicated ownership links within the financial market, and increased activity of regulated entities abroad, and it was not consistent with the growing and increasingly complicated tasks entrusted to it pursuant to law during the preceding years. The FME's tasks demand vast expert knowledge on the operations of banks, economics, accounting, and legislation on financial markets. It is clear that the increase in the FME's budgetary resources came about too late for it to be able to keep pace with the developments in the operations of the financial institutions, and to carry out its statutory supervisory tasks.  However, not all of the FME's difficulties can be attributed to insufficient financial appropriations. Thus, the FME did not sufficiently concern itself with some basic questions, such as the size of the banking system, and the Authority's necessary reactions in regard to its much too rapid growth.  Part of the FME's difficulties was also wrong prioritisation. Although the FME has been in the process of improving and structuring its IT systems since 2006, much greater emphasis should have been placed on installing advanced IT systems. The FME severely lacked the technical expertise and the equipment necessary to produce high quality comprehensive surveys of the position and development of individual financial institutions from its databases. Therefore, the Authority did not really have the necessary overview of the activities of the financial institutions which was so urgently needed. In its supervisory duties the FME was lacking in firmness and assertiveness, as regards the resolution of and the follow-up of cases.  **(i) Failure by auditors**  The auditors did not perform their duties adequately when auditing the financial statements of the financial corporations for 2007 and the semi-annual statements for 2008.  The full report is available on the [Icelandic Parliament](http://sic.althingi.is/" \t "_new) website.  [etailed Contents](http://www.law.unimelb.edu.au/bulletins/152%20April%202010.htm%23h1)  **1.10 Canadian securities regulators issue proposals to improve issuer communications with investors**  On 9 April 2010, the Canadian Securities Administrators (CSA) published for comment proposed amendments to National Instrument 54-101 'Communication with Beneficial Owners of Securities of a Reporting Issuer', the related companion policy, and related instruments.  The proposed amendments aim to improve procedures for issuer communications with investors who hold securities through intermediaries such as dealers, trust companies or banks.  The key aspects of the proposed amendments include:   * The introduction of the "notice-and-access" process, in which reporting issuers have the option of sending investors a notice informing them that the information circular and other proxy-related materials are available on the Internet instead of sending the information circular by mail. * Enhanced disclosure regarding the beneficial owner voting process. * Simplification of the beneficial owner proxy-appointment process.   Copies of the proposed rule amendments and additional background information are available on the websites of CSA members.  The CSA, the council of the securities regulators of Canada's provinces and territories, co-ordinates and harmonizes regulation for the Canadian capital markets.  [etailed Contents](http://www.law.unimelb.edu.au/bulletins/152%20April%202010.htm%23h1)  **1.11 IOSCO publishes disclosure principles for public offerings and listings of asset backed securities**  On 8 April 2010, the Technical Committee of the International Organization of Securities Commission (IOSCO) published a final report titled 'Disclosure Principles for Public Offerings and Listings of Asset Backed Securities' (ABS Disclosure Principles) - containing principles designed to provide guidance to securities regulators who are developing or reviewing their regulatory disclosure regimes for public offerings and listings of asset-backed securities (ABS).  The objective of the ABS Disclosure Principles is to enhance investor protection by facilitating a better understanding of the issues that should be considered by regulators in developing or reviewing their disclosure regimes for ABS.  The ABS Disclosure Principles provide guidance for listings and public offerings of ABS, defined as those securities that are primarily serviced by the cash flows of a discrete pool of receivables or other financial assets that by their terms convert into cash within a finite period of time, such as RMBS (residential mortgage-backed securities) and CMBS (commercial mortgage-backed securities), among others.  The principles are based on the premise that the issuing entity will prepare a document used for a public offering or listing of ABS that will contain all material information, clearly presented, that is necessary for full and fair disclosure of the character of the securities being offered or listed in order to assist investors in making their investment decision.  The ABS Disclosure Principles will complement IOSCO's existing disclosure standards and principles, which include International Disclosure Standards for Cross-Border Offerings and Initial Listings by Foreign Issuers (1998); Principles for Ongoing Disclosure and Material Development Reporting by Listed Entities (2002); General Principles Regarding Disclosure of Management's Discussion and Analysis of Financial Condition and Results of Operations (2003); International Disclosure Principles for Cross-Border Offerings and Listings of Debt Securities by Foreign Issuers (2007); and Principles for Periodic Disclosure by Listed Entities (2010).  The ABS Disclosure Principles would also provide guidance if a Document is required:   * when a financial intermediary that has participated in a public offering of securities later sells to the public the securities that were unsold in the original public offering; or * when the issuer has sold securities in a private placement to any party who then resells those securities to the public.   These principles would not provide guidance for securities backed by assets pools that are actively managed (such as some securities issued by investment companies), or that contain assets that do not by their terms convert to cash (such as collateralized debt obligations).  The ABS Disclosure Principles outline the information that should be included in any offer or listing document for a publicly offered or listed ABS, which should include details on the following:   1. Parties responsible for the document; 2. Identity of parties involved in the transaction; 3. Functions and responsibilities of significant parties involved in the securitization transaction; 4. Static pool information; 5. Pool assets; 6. Significant obligors of pool assets; 7. Description of the asset backed securities; 8. Structure of the transaction; 9. Credit enhancement and other support, excluding certain derivative instruments; 10. Certain derivative instruments; 11. Risk factors; 12. Markets; 13. Information about the public offering; 14. Taxation; 15. Legal proceedings; 16. Reports; 17. Affiliations and certain relationships and related transactions; 18. Interests of experts and counsel; and 19. Additional information.   The report is available on the [IOSCO](http://www.iosco.org/library/pubdocs/pdf/IOSCOPD318.pdf" \t "_new) website.  [etailed Contents](http://www.law.unimelb.edu.au/bulletins/152%20April%202010.htm%23h1)  **1.12 Report on Islamic finance**  On 8 April 2010, the Islamic Financial Services Board (IFSB) published the report "Islamic Finance: Global Financial Stability".  The Report examines the intrinsic strength of the Islamic finance model, the state of the Islamic financial services industry and challenges and strategies for strengthening financial stability in the Islamic financial services industry.  The Report recommends, among other things, the establishment of an Islamic Financial Stability Forum or IFSF. The IFSF will be a dedicated forum to promote cooperation and collaboration among its members in areas such as surveillance, sharing of experiences in crisis prevention, management and resolution, implementation of international standards as well as international cooperation in capacity building and in the development of emergency infrastructure and facilities.  Further information is available on the [IFSB](http://www.ifsb.org/" \t "_new) website.  [etailed Contents](http://www.law.unimelb.edu.au/bulletins/152%20April%202010.htm%23h1)  **1.13 SEC proposes rules to increase investor protections in asset-backed securities**  On 7 April 2010, the US Securities and Exchange Commission (SEC) proposed rules that would revise the disclosure, reporting and offering process for asset-backed securities (ABS) to better protect investors in the securitization market.  The proposed rules are intended to provide investors with more detailed and current information about ABS and more time to make their investment decisions. The proposed rules also seek to better align the interests of issuers and investors by creating a retention or "skin in the game" requirement for certain public offerings of ABS.  Asset-backed securities are created by buying and bundling loans - such as residential mortgage loans, commercial loans or student loans - and creating securities backed by those assets, which are then sold to investors. Often, a bundle of loans is divided into separate securities with different levels of risk and returns. Payments on the loans are distributed to the holders of the lower-risk, lower-interest securities first, and then to the holders of the higher-risk securities.  Most public offerings of ABS are conducted through expedited SEC procedures known as "shelf offerings." ABS offerings also are sold as private placements which are exempt from SEC registration. ABS private placements are typically sold to large institutional investors known as qualified purchasers.  Further information is available on the [SEC](http://www.sec.gov/rules/proposed/2010/33-9117.pdf" \t "_new) website.  [etailed Contents](http://www.law.unimelb.edu.au/bulletins/152%20April%202010.htm%23h1)  **1.14 CEBS publishes draft guidelines on joint assessment and joint decision regarding the capital adequacy of cross border groups**  On 7 April 2010, the Committee of European Banking Supervisors (CEBS) published its draft guidelines on joint assessment and joint decision regarding the capital adequacy of cross border groups. According to Article 129 (3) of the revised Capital Requirements Directive (CRD) which will come into force on 31 December 2010 - consolidating and host supervisors of an EEA cross border banking group shall do everything within their power to reach a joint decision on the application of the Pillar 2 provisions related to the Internal Capital Adequacy Assessment Process (ICAAP) and to the Supervisory Review and Evaluation Process (SREP). The joint decision should cover the adequacy of the consolidated level of own funds held by the group with respect to its financial situation and risk profile, as well as the required level of own funds above the regulatory minimum applied to each entity within the group.  The revised CRD also requires CEBS to publish guidelines to help facilitate the implementation of these provisions and the convergence of supervisory practices with regard to the joint decision process.  The guidelines provide tools to facilitate a common understanding within colleges of the results of assessments of material risks and control factors, the ICAAP processes and methodologies, as well as compliance with various minimum requirements of the CRD performed by national supervisors with reference to CEBS's existing guidance on the Supervisory Review Process (SRP).  The guidelines are available on the [CEBS](http://www.c-ebs.org/documents/Publications/Consultation-papers/2010/CP39/CP39.aspx" \t "_new) website.  [etailed Contents](http://www.law.unimelb.edu.au/bulletins/152%20April%202010.htm%23h1)  **1.15 Market Abuse Directive - CESR reviews options and discretions**  On 6 April 2010, the Committee of European Regulators (CESR) published a review (Ref CESR/09-1120) of how securities regulators across Europe use options and discretions applied by CESR Members under the European Market Abuse Directive regime, (MAD regime) which is made up of the Market Abuse Directive (MAD) and its Level 2 implementing measures as developed by CESR.  The report gives evidence of the wide use of options and discretions by Member States with regard to the MAD regime. CESR's stock take found divergence in how national supervisors disclose information on supervisory measures or sanctions, inside information directors' dealings and suspicious transaction reports.  While acknowledging the legitimate use of options and discretions, under the MAD regime, CESR's Review Panel restates its commitment towards increased convergence of supervisory practices in the EU and recommends that the results of this exercise are taken into account in the ongoing revision of the Market Abuse Directive. This work follows conclusions of the ECOFIN Council of December 2007, on aiming at reducing the use of discretions, and of May 2008 and June 2009, on the need to aim at enhancing supervisory convergence in the EU. CESR's re-commitment to providing convergence is in line with the recent decisions by the EU Parliament and Council of establishing a single European supervisory rule book.  Further information is available on the [CESR](http://www.cesr-eu.org/" \t "_new) website.  [etailed Contents](http://www.law.unimelb.edu.au/bulletins/152%20April%202010.htm%23h1)  **1.16 Report on UK shareholder voting on governance issues**  On 8 April 2010, the Association of British Insurers (ABI) published its Institutional Voting Information Service (IVIS) review, which shows that serious breaches in governance led to a much higher vote against companies in 2009, than 12 months ago. IVIS does not provide voting advice but indicates concerns through a colour code system. Following a red topped report, which indicates a matter of serious concern, an average of 30% of shares were not voted in favour of management last year compared with 13% in 2008.  Of all reports published in 2009 12% were red, 20% were amber and 68% were blue, indicating no areas of major concern. The review also found that executive pay inflation slowed last year with base salaries for FTSE 100 Chief Executives rising by 5.3%. Average bonus payouts were also down to around 90% of base pay compared with over 110% in 2008.  IVIS has reviewed voting issues at over 8500 FTSE All-Share meetings since January 2000, in line with guidelines on governance, sustainability and remuneration. These guidelines are set by the ABI Investment Committee, which includes many of the largest investors in UK plc shares. IVIS subscribers hold 30% of the FTSE All-Share.  Five company reports on remuneration were voted down by investors in 2009. They were Bellway, Provident Financial and Punch Taverns which were red-topped by the ABI, and Royal Dutch Shell and RBS, which were amber-topped.  Further information is available on the [ABI](http://www.abi.org.uk/" \t "_new) website.  [etailed Contents](http://www.law.unimelb.edu.au/bulletins/152%20April%202010.htm%23h1)  **1.17 IMF global financial stability report**  In April 2010, the International Monetary Fund (IMF) published its Global Financial Stability Report which provides a semi-annual assessment of global financial markets and addresses emerging market financing in a global context.  The topics dealt with in the report are:  **(a) Systemic risk and the redesign of financial regulation**   * Implementing Systemic-Risk-Based Capital Surcharges * Reforming Financial Regulatory Architecture Taking into Account Systemic Connectedness * Policy Reflections   **(b) Making over-the-counter derivatives safer: The role of central counterparties**   * The Basics of Counterparty Risk and Central Counterparties * The Case for Over-the Counter Derivative Central Clearing * Incentivizing Central Counterparty Participation and the Role of End-Users * Criteria for Structuring and Regulating a Sound Central Counterparty * How Should Central Counterparties Be Regulated and Overseen? * One versus Multiple Central Counterparties? * Conclusions and Policy Recommendations   **(c) Global liquidity expansion: Effects on "receiving" economies and policy response options**   * Overview of the 2007-09 Global Liquidity Expansion * Effects of the Global Liquidity Expansion on the Liquidity-Receiving Economies * Policy Response Options for Liquidity-Receiving Economies * Effectiveness of Capital Controls * Conclusions   The report is available on the [IMF](http://www.imf.org/external/index.htm" \t "_new) website.  [etailed Contents](http://www.law.unimelb.edu.au/bulletins/152%20April%202010.htm%23h1)  **1.18 Study of securities class actions in the US for 2009**  Federal securities fraud class action filing activity in 2009 was down sharply compared to 2008 and historical averages, according to 'Securities Class Action Filings 2009: A Year in Review', an annual report prepared by the Stanford Law School Securities Class Action Clearinghouse in cooperation with Cornerstone Research.  A total of 169 federal securities class actions were filed in 2009, a 24 percent decline from the 223 observed in 2008, and 14 percent below the average of 197 observed between 1997 and 2008. Litigation activity related to the credit crisis declined even more markedly from 100 filings in 2008 to only 53 in 2009, a 47 percent decrease. Only 17 of those filings occurred in the second half of 2009.  Plaintiff law firms also filed a much larger number of lawsuits long after the date on which the alleged fraud was disclosed to the market. The filing of these delayed class actions was particularly notable in the second half of the year when the median filing lag was 100 days, more than three times the historical average.  According to the authors of the report, the increase in old claims filed during 2009 suggests that plaintiffs are trying to fill the litigation pipeline by bringing older lawsuits that weren't attractive enough to file while the firms were busy pursuing financial sector claims. If history is a guide, these lawsuits are more likely to be dismissed and can therefore be characterized as lower quality claims.  Other trends discussed in the report include market capitalization losses; filings by industry, federal circuit, and stock exchange; and frequency of filings against firms with non-US headquarters.  The average value for settlements in 2009 increased to US$37 million compared with US$28 million in 2008. Securities class action settlements totalled US$3.8 billion in 2009, a jump of more than 35 percent over 2008. The study also reports 103 settlements approved in 2009, up from 97 reported in 2008.  Although the financial sector had the highest industry concentration among 2009 settled cases, these settlements primarily were for cases filed through 2007. For the most part, case filings related to the credit crisis in 2008 have yet to be resolved.  The following are among the key findings:  The median settlement in 2009 was US$8 million, unchanged from 2008. While this is lower than the inflation-adjusted median of US$9.3 million in 2007, it is higher than the median for all cases settled from 1996 through 2008.  Institutional investors continued to participate actively in post-Reform Act securities class actions and served as lead plaintiffs in nearly 65 percent of 2009 settlements. Cases involving public pensions as lead plaintiffs were associated with significantly higher settlements.  Alleged violations of Generally Accepted Accounting Principles (GAAP) were included in more than 65 percent of settled cases in 2009. Cases with GAAP allegations had larger settlement amounts and a higher percentage of estimated "plaintiff-style" damages compared with cases not involving accounting allegations.  The report is available on the [Cornerstone Research Securities](http://securities.cornerstone.com/" \t "_new) website.  [etailed Contents](http://www.law.unimelb.edu.au/bulletins/152%20April%202010.htm%23h1)  **1.19 House of Lords report on future regulation of derivatives markets**  On 31 March 2010, the UK House of Lords European Union Committee published a report titled "The future regulation of derivatives markets: Is the EU on the right track?" The report assesses whether EU legislation for the derivatives market is appropriate, the effect that proposals for reform will have on market stability, and whether reform will address the criticised opaqueness of the derivatives market.  In particular, the report examines the European Commission's Communications on "Ensuring efficient, safe and sound derivatives markets". The report notes that derivatives are used by businesses to hedge against risks outside of their control, for example fluctuations in commodity prices. However, they are also used as tools for financial speculation. The lack of transparency in the derivatives market and the failure to identify a build-up in risk can cause market instability.  The Committee found that the Commission proposals for increasing transparency in the so called Over-the-Counter (OTC) derivatives market, through reporting OTC derivatives contracts which are not centrally cleared to a trade repository, will go some way to addressing concerns that the OTC derivatives market is opaque and ineffectively supervised. The Committee also found support amongst witnesses for increased use of standardised contracts and of central clearing. However, there are questions as to what types of contracts will be covered by the Commission's definition of derivatives. A consequence of a wide definition could be to extend application of the regulation to derivatives used by non-financial businesses that have little effect on financial stability.  The Commission suggestion that central clearing for all standardised products should be mandatory did raise some issues. This proposal if adopted could increase risk by forcing clearing houses to clear products for which they cannot manage the associated risk effectively. Moreover, not all derivatives contracts are suitable for standardisation. Applying capital charges to encourage standardisation, rather than on a basis proportionate to risk, could have adverse effects on stability and increase the costs of using derivatives to manage risk.  The Committee found that the EU would be an appropriate level for regulation for minimum standards for central counterparties, provided that the standards mirror those developed at a global level. However, the suggestion of the Commission that the European Securities and Markets Authority (ESMA) would be an appropriate body to conduct authorisation and supervision of central counterparties met with some opposition from witnesses. The Committee found that, in the absence of any cross border fiscal burden-sharing arrangements for failing financial institutions, central counterparties cannot be supervised at an EU level because the EU itself does not have the financial resource within the budget to bail out a large central counterparty. Overall the Committee welcomes the apparent direction of the Commission's proposals.  The report is available on the [Committee](http://www.publications.parliament.uk/pa/ld200910/ldselect/ldeucom/93/93.pdf" \t "_new) website.  [etailed Contents](http://www.law.unimelb.edu.au/bulletins/152%20April%202010.htm%23h1)  **1.20 Removal of large deposits and wholesale funding guarantee for Australian financial institutions**  On 31 March 2010, the Australian Treasurer, the Hon Wayne Swan MP, announced the closure of the Guarantee of Large Deposits and Wholesale Funding.  The Council of Financial Regulators had advised that no Australian bank, building society or credit union will need the Guarantee to fund itself due to improvements in bank funding conditions.  Australian depositors will continue to be protected by the Financial Claims Scheme - a separate policy giving free coverage for all deposits up to $1 million. That $1 million cap will continue until at least October 2011, when it will be reviewed.  [etailed Contents](http://www.law.unimelb.edu.au/bulletins/152%20April%202010.htm%23h1)  **1.21 Australian government announces in principle approval of new entrant in financial markets trade execution service**  On 31 March 2010, the Australian Minister for Financial Services, Superannuation and Corporate Law, Chris Bowen MP, announced the Government's support for competition between markets for trading in listed shares in Australia.  Minister Bowen announced in-principle approval of Chi-X Australia Pty Ltd's (Chi-X's) Australian market licence application. Chi-X is a wholly-owned Australian-incorporated subsidiary of Chi-X Global Inc, which already operates markets throughout Europe and Canada.  While competition between financial markets for trade execution services is new to Australia, alternative trading systems have successfully operated in the US and Europe for a number of years.  A final decision on Chi-X's licence application will be made after the necessary regulatory framework is in place and other requirements have been met. The steps to be undertaken to finalise the regulatory framework include relevant amendments to the Corporations Regulations 2001 and the settling of ASIC-set market integrity rules.  According to the government, the introduction of competition will be a significant change in Australia's market structure with implications for price discovery, compliance and best execution.  Other applications for market licences will also be considered on their merits, in accordance with the requirements set out in the [Corporations Act 2001](http://my.lawlex.com.au/index.asp?pact=coredoc&nav=col&cid=56482" \t "Default).  [etailed Contents](http://www.law.unimelb.edu.au/bulletins/152%20April%202010.htm%23h1)  **1.22 Report on building high performance boards**  On 31 March 2010, the Canadian Coalition for Good Governance (CCGG) published its revised building high performance boards report. CCGG has published the report to provide boards guidance on how they may structure themselves and their policies so that they may foster good governance practices.  The report is available on the [CCGG](http://www.ccgg.ca/site/ccgg/assets/pdf/CCGG_Building_High_Performance_Boards_Final_March_2010.pdf" \t "_new) website.  [etailed Contents](http://www.law.unimelb.edu.au/bulletins/152%20April%202010.htm%23h1)  **1.23 Hong Kong consultation begins on draft guidelines on disclosure of inside information**  On 29 March 2010, the Hong Kong Securities and Futures Commission (SFC) begun soliciting public comments on a draft set of guidelines to explain "inside information" and its application, in parallel with the Government's publication of proposals to make it statutory for listed corporations to make timely disclosure of "price-sensitive information".  The Government's consultation paper (Note 1) proposes to include in the Securities and Futures Ordinance (SFO) a statutory requirement for a listed corporation to disclose to the public as soon as practicable "price-sensitive information" that has come to its knowledge.  As part of the proposals, the SFC has drafted guidance on what constitutes "inside information", a new term used in the proposed legislation to mean "price sensitive information". "Safe harbours" and how they would apply are also described in the "Draft Guidelines on Disclosure of Inside Information".  The consultation paper is available on the [Hong Kong Financial Services and the Treasury Bureau](http://www.fstb.gov.hk/eng/sfst/main.html" \t "_new) website.  [etailed Contents](http://www.law.unimelb.edu.au/bulletins/152%20April%202010.htm%23h1)  **1.24 US director remuneration survey**  US corporate board pay levels are flat or down compared to last year, according to The National Association of Corporate Directors (NACD)'s Annual Director Compensation Survey: 2009-2010, published on 29 March 2010.  Created in partnership with consulting firm Pearl Meyer & Partners, the report examines director pay trends among public boards in four size categories, along with a fifth category of the Top 200 companies - ranging in revenues from US$50 million to over US$10 billion - across multiple industry verticals.  The report also shows a link between the composition of director compensation and the current economic environment. Cash compensation, consisting of annual retainers and fees for board and committee service, represented a greater proportion of total compensation. The percentage of director pay in the form of equity declined significantly, largely as a result of lower share prices. While stock compensation was generally below the 50% benchmark, there was also a significant shift away from the use of stock options in favour of full-value share grants.  **Key highlights**  Median total direct compensation:   * Companies with revenues of US$50 million to US$500 million - decreased 3% to US$75,490 * Companies with revenues of US$500 million to US$1 billion - decreased 6% to US$108,836 * Companies with revenues of US$1 billion to US$2.5 billion - decreased 2% to US$131,054 * Companies with revenues of US$2.5 billion to US$10 billion - decreased 1% to US$164,455 * Companies with revenues over US$10 billion plus - increased 1% to US$216,186   Compensation by industry:   * Highest compensated included: Pharmaceutical & Medical Products, Diversified Financial & Brokerage, Petroleum/Crude Oil Production & Pipelines and Computer Products & Services * Lowest compensated included: Transportation & Distribution, Motor Vehicles & Parts and Banks/Savings & Loans   From an organizational perspective, the NACD report found that the work of corporate boards is being conducted increasingly at the committee level as directors seek to most effectively address the volume of issues they face. Virtually all companies in the survey maintained audit and compensation committees with the vast majority also having a governance/nominating committee. A sizeable majority of companies differentiate pay among committees in some way, reflecting the difference in relative workloads.  Continuing a practice begun in the wake of Sarbanes-Oxley, audit committee member compensation is highest, reflecting a significant rise in responsibilities and time commitment required as a result of regulation. Compensation committees follow, due largely to increased workloads and a more intense scrutiny of their decisions by all stakeholders.  The report is available for purchase on the [NACD](https://secure.nacdonline.org/source/orders/index.cfm?SKU=SUR%2D058" \t "_new) website.  [etailed Contents](http://www.law.unimelb.edu.au/bulletins/152%20April%202010.htm%23h1)  **1.25 FSA publishes rules on adviser charging**  On 26 March 2010, the UK Financial Services Authority (FSA) published new rules that will remove commission bias from advice on retail investment products.  The Retail Distribution Review (RDR) aims to provide customers with vital information about the cost and nature of the advice they are receiving. They will be able to agree the cost of that advice with their adviser, rather than it being decided by the provider of the product. The FSA states that from the end of 2012, firms will have to be upfront about how much they charge for their services, and no longer hide the cost of their advice behind the cost of a product. In addition, firms will not be able to accept commissions in return for recommending specific products.  The changes also mean firms offering independent advice will have to demonstrate that their recommendations are based on a comprehensive and unbiased analysis of the market, and that any product selection is made in their clients' best interests. However, if a firm chooses to limit it's product range to certain investments or strategies, then the services it offers are restricted, and this should be clearly set out for customers.  The policy statement is accompanied by a discussion paper on platforms and a consultation paper on pure protection.  These documents are available on the [FSA](http://www.fsa.gov.uk/pages/Library/Policy/Policy/2010/10_06.shtml" \t "_new) website.  [etailed Contents](http://www.law.unimelb.edu.au/bulletins/152%20April%202010.htm%23h1)  **1.26 Report on lessons distilled from funding market disruptions**  On 25 March 2010, the Committee on the Global Financial System (CGFS) released a report entitled 'The Functioning and Resilience of Cross-Border Funding Markets' prepared by a joint Study Group of the CGFS and the Markets Committee.  The report examines the funding market disruptions during the recent financial crisis, reviews the policy responses and distils the following lessons:   * The build-up of maturity mismatches by internationally active banks was a major vulnerability and should be better monitored and managed. The principal threat to stability was not cross-border activity itself, but the inadequate recognition and management of the related risks, especially those arising from reliance on short-term funding and exposure to potentially illiquid assets. * The crisis did, however, highlight the resilience of the foreign exchange markets, which continued to function despite severe pressures. While initiatives to upgrade market infrastructure should be welcomed, care should be taken not to let reform efforts inadvertently undermine markets that have proved to function well. * The immediate policy responses, including central bank swap and repo lines and the use of own foreign exchange reserves, were effective and appropriate for this episode. In other situations, different policy tools might prove more suitable. Policymakers should continue to explore other viable options so that they can respond flexibly in different crisis scenarios.   The report is available on the [CGFS](http://www.bis.org/publ/cgfs37.pdf?noframes=1" \t "_new) website.  [etailed Contents](http://www.law.unimelb.edu.au/bulletins/152%20April%202010.htm%23h1)  **1.27 SEC staff evaluating the use of derivatives by funds**  On 25 March 2010, the US Securities and Exchange Commission (SEC) announced that it is conducting a review to evaluate the use of derivatives by mutual funds, exchange-traded funds (ETFs) and other investment companies. The review will examine whether and what additional protections are necessary for those funds under the Investment Company Act of 1940.  The SEC intends to explore issues related to the use of derivatives by funds, including, among other things, whether:   * current market practices involving derivatives are consistent with the leverage, concentration and diversification provisions of the Investment Company Act; * funds that rely substantially upon derivatives, particularly those that seek to provide leveraged returns, maintain and implement adequate risk management and other procedures in light of the nature and volume of the fund's derivatives transactions; * fund boards of directors are providing appropriate oversight of the use of derivatives by funds; * existing rules sufficiently address matters such as the proper procedure for a fund's pricing and liquidity determinations regarding its derivatives holdings; * existing prospectus disclosures adequately address the particular risks created by derivatives; and * funds' derivative activities should be subject to special reporting requirements.   The SEC also will seek to determine what, if any, changes in Commission rules or guidance may be warranted.  [etailed Contents](http://www.law.unimelb.edu.au/bulletins/152%20April%202010.htm%23h1)  **1.28 APRA consults on proposals for the supervision of conglomerate groups**  On 18 March 2010, the Australian Prudential Regulation Authority (APRA) released a discussion paper containing proposals on supervising conglomerate groups. These are groups with APRA-regulated entities that have material operations in more than one APRA-regulated industry and/or have material unregulated entities.  APRA's proposed 'Level 3' supervision framework is designed to complement its existing industry-based supervision of stand-alone entities (Level 1 supervision) and its supervision of single industry groups (Level 2 supervision).  The Level 3 framework contains proposals, building on APRA's existing capital requirements, to ensure that a conglomerate group holds adequate capital to protect the APRA-regulated entities from potential contagion and other risks within the group. The framework also contains proposals on a range of principles-based risk management and governance standards that will apply to the parent company of the Level 3 group.  Submissions on the Level 3 proposals are invited by 18 June 2010. Following this initial consultation, APRA will release draft prudential standards and reporting standards to implement the Level 3 framework. These standards will also be subject to public consultation.  The discussion paper is available on the [APRA](http://www.apra.gov.au/Policy/Supervision-of-conglomerate-groups.cfm" \t "_new) website.  [etailed Contents](http://www.law.unimelb.edu.au/bulletins/152%20April%202010.htm%23h1)  **1.29 Recommendations for strengthening cross-border bank resolution frameworks - final paper issued by Basel Committee**  On 18 March 2010, the Basel Committee on Banking Supervision issued its final paper titled 'Report and Recommendations of the Cross-border Bank Resolution Group'.  The report, which was first issued for consultation in September 2009, sets out 10 recommendations that fall into three categories:   * **Strengthening national resolution powers and their cross-border implementation.** National authorities need to have powers to intervene sufficiently early and to ensure the continuity of critical functions. * **Firm-specific contingency planning.** Banks, as well as key home and host authorities, should develop practical and credible plans to promote resiliency in periods of severe financial distress and to facilitate a rapid resolution should that be necessary. The plans should ensure access to relevant information in a crisis and assist the authorities' evaluation of resolution options. One of the main lessons from the crisis was that the enormous complexity of corporate structure makes resolutions difficult, costly and unpredictable. * **Reducing contagion.** Risk mitigation through mechanisms such as netting arrangements, collateralisation practices and the use of regulated central counterparties should be strengthened to limit the market impact of a bank failure.   The report is available on the [BIS](http://www.bis.org/publ/bcbs169.htm" \t "_new) website.  [etailed Contents](http://www.law.unimelb.edu.au/bulletins/152%20April%202010.htm%23h1)  **1.30 Proposed enhancements to Singapore corporate governance framework**  On 18 March 2010, the Monetary Authority of Singapore (MAS) issued a consultation paper that sets out proposed enhancements to the MAS Corporate Governance (CG) Framework which comprises the Regulations and Guidelines for locally-incorporated banks, financial holding companies and direct insurers.  The proposals emphasise the importance of the role of the Board and the need for directors to be equipped with the appropriate skills and have the commitment to oversee the operations of the financial institutions. In addition, independent directors play an important role on the Board as they serve as the check and balance to management and majority shareholders and protect the interests of the financial institutions as a whole. Accordingly, MAS has proposed including an additional criterion on the length of board service in the definition of independence and changes to the composition of the board and board committees.  Specifically the key proposals in the consultation paper relate to:  **(i) Continuous development**  The Nominating Committee (the NC) must assess the current skills of the Board on an annual basis and should establish a continuous development program for its directors.  **(ii) Time commitment**  The NC should set internal guidance on the time commitment expected of each director to ensure that directors are able to devote the time needed to perform their oversight roles.  **(iii) Director independence**  A director will be considered non-independent after he/she has served on the Board for a continuous period of nine years; financial institutions should consider appointing a lead independent director if the Board Chairman has other relationships with the financial institution; the financial institution shall not appoint a person who is a member of the immediate family of the CEO as the Board Chairman. This does not affect existing Board Chairmen who do not meet this requirement, subject to annual approval by MAS.  **(iv) Composition of Board and Board Committees**  To raise the number of independent directors on the Board, the NC and the Remuneration Committee (the RC) from one third to a majority.  **(v) Governance over remuneration framework and practices**  To include additional factors that the RC must consider in the design and operation of the remuneration framework and additional guidance for financial institutions to adopt the Principles and Standards on Sound Compensation Practices of the Financial Stability Board (FSB).  **(vi) Governance of risk management**  The Board must establish a dedicated risk management committee and financial institutions must seek MAS' approval for the appointment of the Chief Risk Officer. MAS will provide additional guidance its expectations on roles, responsibilities and skills of the Board in overseeing the financial institution's risk management system.  MAS expects that most of the proposals in the enhanced CG Framework will take effect from the first Annual General Meeting of each financial institution held on or after 1 January 2011. Exceptions will be given to proposals on the introduction of a new requirement for a director to be deemed non-independent after he/she has served for a continuous period of nine years on the Board; and the raising of the number of independent directors on the Board, NC and RC from the current one-third to a majority. MAS proposes these two changes take effect no later than from the first Annual General Meeting of each financial institution held on or after 1 January 2012. This is to take into consideration that financial institutions may need time to reconfigure their Boards and Board Committees to meet the proposed requirements on independence and composition.  The consultation paper is available on the [MAS](http://www.mas.gov.sg/resource/publications/consult_papers/2010/Consultation_Paper_on_CG_Regs_and_Guidelines.pdf" \t "_new) website.  [etailed Contents](http://www.law.unimelb.edu.au/bulletins/152%20April%202010.htm%23h1)  **1.31 Disclosure guide for private equity**  On 17 March 2010, the Guidelines Monitoring Group (GMG) published a transparency and disclosure reporting guide for private equity general partners and their portfolio companies.  The guide is available on the [BVCA](http://admin.bvca.co.uk/library/documents/GMG_Improving_transparency_and_disclosure.pdf" \t "_new) website.  [etailed Contents](http://www.law.unimelb.edu.au/bulletins/152%20April%202010.htm%23h1)  **1.32 Principles for enhancing corporate governance issued by Basel Committee**  On 16 March 2010, the Basel Committee on Banking Supervision (BIS) issued for consultation a set of principles for enhancing sound corporate governance practices at banking organisations.  Drawing on lessons learned during the financial crisis, the Basel Committee's document titled 'Principles for Enhancing Corporate Governance', sets out best practices for banking organisations.  The Committee's principles address fundamental deficiencies in bank corporate governance that became apparent during the financial crisis. The principles cover:   * the role of the board, which includes approving and overseeing the implementation of the bank's risk strategy taking account of the bank's long-term financial interests and safety; * the board's qualifications. For example, the board should have adequate knowledge and experience relevant to each of the material financial activities the bank intends to pursue to enable effective governance and oversight of the bank; * the importance of an independent risk management function, including a chief risk officer or equivalent with sufficient authority, stature, independence, resources and access to the board; * the need to identify, monitor and manage risks on an ongoing firm-wide and individual entity basis. This should be based on risk management systems and internal control infrastructures that are appropriate for the external risk landscape and the bank's risk profile; and * the board's active oversight of the compensation system's design and operation, including careful alignment of employee compensation with prudent risk-taking, consistent with the Financial Stability Board's principles.   The principles also stress the importance of board and senior management having a clear knowledge and understanding of the bank's operational structure and risks. This includes risks arising from special purpose entities or related structures.  Supervisors also have a critical role in ensuring that banks practice good corporate governance. In line with the Committee's principles, supervisors should establish guidance or rules requiring banks to have robust corporate governance strategies, policies and procedures. Commensurate with a bank's size, complexity, structure and risk profile, supervisors should regularly evaluate the bank's corporate governance policies and practices as well as its implementation of the Committee's principles.  The principles are available on the [BIS](http://www.bis.org/publ/bcbs168.htm" \t "_new) website.  [etailed Contents](http://www.law.unimelb.edu.au/bulletins/152%20April%202010.htm%23h1)  **1.33 CalPERS seeks majority vote standard at top publicly traded companies**  On 15 March 2010, the California Public Employees' Retirement System announced plans to ask 58 of the top US companies in its global equity portfolio to voluntarily adopt the majority vote standard in uncontested elections for corporate directors. If the companies fail to act they could face a shareholder resolution by the Pension Fund.  CalPERS will ask the target companies drawn from the Pension Fund's largest holdings to adopt the corporate governance best practice where unopposed Board candidates would be elected by a majority instead of plurality vote, which would be retained for contested director elections.  Under the plurality vote standard, shareowners can oppose candidates by casting "withhold" votes but have no voice in the outcome since candidates for uncontested seats need to receive only a single "for" vote.  Many US companies have a "default" provision for board elections which mean that shareholders can vote only in favour of the board's own nominees or cast a "withhold" vote to indicate their opposition.  As of September 2009, approximately 71 percent of S&P 500 companies and 50 percent of Russell 1000 companies had adopted some form of policy for director resignations or majority vote standards for director elections.  CalPERS, with approximately US$205 billion in assets, is the US's largest public pension fund.  Further information is available on the [CalPERS](http://www.calpers-governance.org/" \t "_new) website.  [etailed Contents](http://www.law.unimelb.edu.au/bulletins/152%20April%202010.htm%23h1)  **1.34 Corporate governance guidance and principles for unlisted companies in Europe**  The European Confederation of Directors' Association (EcoDa) has published a report titled "Corporate governance guidance and principles for unlisted companies in Europe." The report provides guidance for unlisted companies on corporate governance. It contains a set of 14 best practice principles and examples of good governance in certain unlisted companies.  The report is available on the [UK Institute of Directors'](http://www.iod.com/intershoproot/eCS/Store/en/pdfs/policy_article_corp_gov_unlisted_companies_eu.pdf" \t "_new) website.  [etailed Contents](http://www.law.unimelb.edu.au/bulletins/152%20April%202010.htm%23h1) | |  |  |  |  |  | | --- | --- | --- | --- | | |  |  |  | | --- | --- | --- | | **2. Recent ASIC Developments** |  | [ext Section](http://www.law.unimelb.edu.au/bulletins/152%20April%202010.htm%233) | | | http://my.lawlex.com.au/alert/pic/spacer.gif | | |  | | --- | | **2.1 ASIC releases guidance on regulation of clearing and settlement facilities**  On 20 April 2010, the Australian Securities and Investments Commission (ASIC) released regulatory guidance on its approach to the licensing and regulation of clearing and settlement (CS) facilities.  ASIC's Regulatory Guide 211 'Clearing and settlement facilities: Australian and overseas operators' (RG 211) has been released in anticipation of more CS facilities seeking to operate in Australia. It responds to international regulatory developments promoting the use of central counterparty (CCP) clearing and settlement of over-the-counter (OTC) derivative transactions.  RG 211 provides guidance on:   * when an Australian CS facility licence will be required; * how to apply for a CS facility licence; and * ASIC's approach to exemptions.   A CCP interposes itself between counterparties in financial transactions, becoming the buyer to the seller and the seller to the buyer. A well designed CCP, with appropriate risk management arrangements, reduces the risk of settlement failure faced by participants and contributes to the goal of financial stability.  A number of international supervisory bodies such as the Financial Stability Board, the International Organization of Securities Commissions and the Basel Committee on Banking Supervision have made recommendations for addressing the weaknesses that have produced the recent crisis and for strengthening the financial system going forward. One theme of those recommendations was to promote wider use of CCP clearing for OTC derivatives.  RG 211 responds to these international developments and consolidates ASIC's policy guidance on licensing and regulation of CS facilities in Australia. Some selective guidance about clearing and settlement was previously included in:   * Regulatory Guide 54 Principles for cross border financial services regulation (RG 54); * Regulatory Guide 172 Australian market licences: Australian operators (RG 172); * Regulatory Guide 176 Licensing: Discretionary powers - wholesale foreign financial services providers (RG 176); and * Regulatory Guide 177 Australian market licences: Overseas operators (RG 177).   Under section 820A of the [Corporations Act](http://my.lawlex.com.au/index.asp?pact=coredoc&nav=col&cid=56482" \t "_default), a CS facility, including a CCP clearing OTC derivatives, which operates in Australia must hold an Australian CS facility licence unless the CS facility is exempted from the requirement to do so by the Minister.  Currently, five licensed CS facilities are authorised to operate in Australia in accordance with Chapter 7 of the Corporations Act. They are the two clearing houses and the two settlement facilities of the ASX Group, and IMB Limited, which provides a CS facility to settle transactions in its own shares. No CSF licence exemptions have ever been granted.  Regulatory Guide 211 Clearing and settlement facilities: Australian and overseas operators (RG 211) is available [here](http://www.asic.gov.au/asic/pdflib.nsf/LookupByFileName/rg211.pdf/$file/rg211.pdf" \t "_new).  Report 194 Response to submissions on CP 120 Operators of clearing and settlement facilities (REP 194) is available [here](http://www.asic.gov.au/asic/pdflib.nsf/LookupByFileName/rep194.pdf/$file/rep194.pdf" \t "_new).  [etailed Contents](http://www.law.unimelb.edu.au/bulletins/152%20April%202010.htm%23h2)  **2.2 ASIC consults to improve disclosure by infrastructure entities**  On 19 April 2010, the Australian Securities and Investments Commission (ASIC) released a consultation paper aimed at improving disclosure to retail investors by infrastructure entities, including listed and unlisted companies and registered managed investment schemes.  ASIC is proposing a benchmark-based disclosure model for infrastructure entities, against which they must report. The proposed benchmarks focus on key issues including corporate structure and management, funding, assumptions in models and sensitivity analysis of those assumptions, valuation, distribution, withdrawal and diversification.  Comments on the consultation paper are due by 30 June 2010, with ASIC proposing to release a regulatory guide in September 2010.  ASIC will produce a companion investor guide.  The consultation paper is available on the [ASIC](http://www.asic.gov.au/asic/pdflib.nsf/LookupByFileName/cp134.pdf/$file/cp134.pdf" \t "_new) website.  [etailed Contents](http://www.law.unimelb.edu.au/bulletins/152%20April%202010.htm%23h2)  **2.3 ASIC consults to improve agribusiness scheme disclosure**  On 8 April 2010, the Australian Securities and Investments Commission (ASIC) released a consultation paper aimed at improving disclosure to retail investors by responsible entities of agribusiness schemes.  ASIC is proposing a benchmark-based disclosure model for unlisted agribusiness schemes, against which the responsible entities must report. The ten proposed benchmarks focus on key issues such as fee models, the financial position of the responsible entity, arrangements around access to land, water and other licenses and related party arrangements.  Comments on the consultation paper are due by 31 May 2010, with ASIC proposing to release a regulatory guide in July 2010.  Responsible entities of existing agribusiness schemes will be required to report against the benchmarks to existing investors by 30 September 2010 and include the required disclosure in all Product Disclosure Statements issued after 30 September 2010.  ASIC will produce a companion investor guide.  The consultation paper is available on the [ASIC](http://www.asic.gov.au/asic/pdflib.nsf/LookupByFileName/cp133.pdf/$file/cp133.pdf" \t "_new) website.  [etailed Contents](http://www.law.unimelb.edu.au/bulletins/152%20April%202010.htm%23h2)  **2.4 Registration opens for licensees under the new national consumer credit regime**  As of 1 April 2010, lenders, brokers and intermediaries dealing in consumer credit can register for an Australian Credit Licence, a key new requirement under the new National Consumer Credit Protection Act (National Credit Act).  Registration is the first step in complying with the new licensing obligations under the National Credit Act. The legislation establishes a national licensing regime to require providers of consumer credit and brokers and intermediaries to obtain a licence from ASIC.  Credit providers and businesses involved in helping consumers obtain credit can register for a credit licence from 1 April 2010 until 30 June 2010. However, to ensure applications can be processed in time, applicants are encouraged to register by 18 June 2010. Registering with ASIC will allow people to continue to engage in credit activities from 1 July 2010 until the licence application process is complete. Registered credit participants will then have six months to apply for a credit licence, between 1 July 2010 and 31 December 2010.  When people apply for registration, they need to show that they can meet certain requirements that will apply to them as credit licensees. Membership of an external dispute resolution body is required; background checks will be needed so that certain statements about the past conduct of directors, company secretaries, partners or trustees involved in a business can be provided, and updates to existing entries on other ASIC registers should also be made.  Further information about the national consumer credit protection regime is available on the [ASIC](http://www.asic.gov.au/credit" \t "_new) website.  [etailed Contents](http://www.law.unimelb.edu.au/bulletins/152%20April%202010.htm%23h2)  **2.5 Guidance for credit licensees about compensation and insurance obligations**  On 30 March 2010, the Australian Securities and Investments Commission (ASIC) released regulatory guidance for credit licensees and insurers about the compensation and professional indemnity (PI) insurance obligations under the National Consumer Credit Protection Act (National Credit Act).  Regulatory Guide 210 "Compensation and insurance arrangements for credit licensees" (RG 210) sets out how credit licensees can meet their obligation to have adequate compensation arrangements.  Licensees must have arrangements in place for compensating their clients for any loss they suffer if the licensee or its representatives breach their obligations. The primary way to comply with this obligation is to have PI insurance.  RG 210 provides ASIC's view on what is 'adequate' PI insurance for the purposes of the National Credit Act, including the level and scope of cover that should be provided by a PI insurance policy.  The National Credit Act requires people who currently engage in credit activities to apply for an Australian Credit Licence between 1 July and 30 December 2010. This follows an initial registration period (1 April - 30 June 2010). The compensation and PI insurance obligations for a licensee commence from the date the licence is issued.  The National Credit Regulations exempt certain categories of credit licensees from the requirement to hold PI insurance, including credit licensees that are regulated by APRA, and licensees whose sole business is lending and that do not undertake any non-lending credit activities (with the exception of credit services provided in relation to their own loans and credit leases). These exempt licensees are able to determine whether to meet their obligation to have in place adequate compensation arrangements by PI insurance or some other means.  The guide is available on the [ASIC](http://www.asic.gov.au/asic/pdflib.nsf/LookupByFileName/rg210.pdf/$file/rg210.pdf" \t "_new) website.  [etailed Contents](http://www.law.unimelb.edu.au/bulletins/152%20April%202010.htm%23h2) | |  |  |  |  |  | | --- | --- | --- | --- | | |  |  |  | | --- | --- | --- | | **3. Recent ASX Developments** |  | [ext Section](http://www.law.unimelb.edu.au/bulletins/152%20April%202010.htm%234) | | | http://my.lawlex.com.au/alert/pic/spacer.gif | | |  | | --- | | **3.1 Reports**  On 7 April 2010, the Australian Securities Exchange (ASX) released:   * the ASX Group Monthly Activity Report; * the SFE Monthly Volume and Open Interest Report; and * the ASXMS Quarterly Activity Report   for March 2010.  These reports are available on the [ASX](http://www.asx.com.au/" \t "_new) website.  [etailed Contents](http://www.law.unimelb.edu.au/bulletins/152%20April%202010.htm%23h3)  **3.2 Restructure of the ASX and SFE operating rules**  New operating rules are to be introduced for the ASX and SFE markets. It is intended that the SFE market be renamed the ASX 24 market in the future, and this name has been used in the draft Rules. On 1 April ASX released draft copies of the new ASX Operating Rules and ASX 24 Operating Rules for public comment. The amended Rules have been informally lodged with ASIC and are subject to consideration by ASIC and the Ministerial non-disallowance process under the Corporations Act.  The exposure drafts of the ASX Operating Rules and ASX 24 Operating Rules along with a document explaining the changes are available on ASX.com.au.  The ASX Operating Rules are available [here](http://www.asx.com.au/supervision/rules_guidance/changes/asx_operating_rules.pdf" \t "_new).  The ASX 24 Operating Rules are available [here](http://www.asx.com.au/supervision/rules_guidance/changes/asx_24_operating_rules.pdf" \t "_new).  [etailed Contents](http://www.law.unimelb.edu.au/bulletins/152%20April%202010.htm%23h3)  **3.3 ASX submission to ASIC consultation paper 131**  On 26 March ASX issued a submission to ASIC Consultation Paper 131 re Proposed ASIC Market Integrity Rules - ASX and SFE markets. This submission includes discussion in relation to:   * the need for clarity as to the respective roles of ASIC and market licensees following the transfer of supervisory functions to ASIC; * the scope of ASIC's Market Integrity Rules; * restructuring of the ASX Market Rules and SFE Operating Rules; and * specific issues in relation to the draft Market Integrity Rules.   The ASX Submission is available on the [ASX](http://www.asx.com.au/about/pdf/20100329_proposed_asic_market_integrity_rules.pdf" \t "_new) website.  [etailed Contents](http://www.law.unimelb.edu.au/bulletins/152%20April%202010.htm%23h3) | |  |  |  |  |  | | --- | --- | --- | --- | | |  |  |  | | --- | --- | --- | | **4. Recent Takeovers Panel Developments** |  | [ext Section](http://www.law.unimelb.edu.au/bulletins/152%20April%202010.htm%235) | | | http://my.lawlex.com.au/alert/pic/spacer.gif | | |  | | --- | | **4.1 Panel publishes consultation paper**  On 20 April 2010, the Takeovers Panel released a consultation paper seeking public comment in relation to:   * A rewritten Guidance Note 1 on Unacceptable Circumstances. The Panel has included an example relating to reverse takeovers to assist the market with guidance in this area following a couple of recent Panel matters. This draft guidance note is part of the Panel's program of updating guidance and simplifying its procedures and documentation. * A draft Guidance Note on Recommendations and Undervalue Statements, to assist the market with guidance following a couple of recent Panel matters involving target recommendations.   The Panel seeks comments from interested persons on the draft Guidance Notes by 21 May 2010.  The consultation paper is available on the [Panel](http://www.takeovers.gov.au/content/DisplayDoc.aspx?doc=consultation%5C034.htm&pageID=&Year=" \t "_new) website.  [etailed Contents](http://www.law.unimelb.edu.au/bulletins/152%20April%202010.htm%23h4)  **4.2 Panel publishes revised Procedural Rules**  On 14 April 2010, the Takeovers Panel published revised Procedural Rules.  The Panel issued a consultation draft of the rules in October 2009. It received 5 submissions and has taken them into account and made further changes. These are summarised, and the Panel's response is set out, in the public consultation response document.  The new rules will apply in respect of all applications made on or after 1 June 2010, at which time they replace the rules of procedure dated 18 June 2004 (as amended) and Guidance Note 8 on Matter Procedures. The former rules and Guidance Note 8 continue to apply to an application made to the Panel before the new rules take effect. The new rules are available from the Panel's website on the rules for proceedings page.  The former rules, Guidance Note 8 and the public consultation draft will remain on the [Panel](http://www.takeovers.gov.au/" \t "_new) website.  [etailed Contents](http://www.law.unimelb.edu.au/bulletins/152%20April%202010.htm%23h4) | |  |  |  |  |  | | --- | --- | --- | --- | | |  |  |  | | --- | --- | --- | | **5. Recent Corporate Law Decisions** |  | [ext Section](http://www.law.unimelb.edu.au/bulletins/152%20April%202010.htm%236) | | | http://my.lawlex.com.au/alert/pic/spacer.gif | | |  | | --- | | **5.1 Deed of company arrangement – power of a court to set aside**  (By Charlotte Poole and Tim Lee, Corrs Chambers Westgarth)  Q.B.I. Corporation Pty Ltd v Plantation Rise Pty Ltd [2010] QSC 102, Queensland Supreme Court, Wilson J, 1 April 2010  The full text of this judgment is available at:  [http://cclsr.law.unimelb.edu.au/judgments/states/qld/2010/april/2010qsc102.htm](http://cclsr.law.unimelb.edu.au/judgments/states/qld/2010/april/2010qsc102.htm" \t "_new)  or  [http://cclsr.law.unimelb.edu.au/judgments/search/advcorp.asp](http://cclsr.law.unimelb.edu.au/judgments/search/advcorp.asp" \t "_new)  **(a) Summary**  Q.B.I. Corporation Pty Ltd (Applicant) was an unsecured creditor of Plantation Rise Pty Ltd (Company). The Company was placed under administration in September 2009 and, pursuant to a resolution of the Company's creditors, subsequently entered into a Deed of Company Arrangement (DOCA). In or around November 2009, the Applicant sought orders from the Supreme Court setting aside the creditors' resolution and the DOCA, as well as a declaration that the claims of creditors as at the date of execution of the DOCA had not been extinguished and an order that the Company be wound up. The Applicant sought this relief on the grounds of an irregularity in the vote approving execution of the DOCA, and that the DOCA was contrary to the interests of creditors and unfairly prejudicial to the Applicant.  Using the powers granted to the Court under section 447A of the [Corporations Act 2001](http://my.lawlex.com.au/default.asp?cid=56482&itid=0&ntid=0&nid=&alpha=&alphaid=&jurid=&ihl=&nhl=&fp=&top=exp&nav=col&pact=coredoc" \t "_default) (the Act), Justice Wilson granted the relief sought by the Applicant. Her Honour found that this section granted the court broad powers, including the power to set aside a DOCA ab initio, even when it had been "terminated by performance" under section 445C of the Act. The Court dealt with the subsidiary issue of the extinguishment of creditor claims under the terms of the DOCA by exercising its power under section 447A to modify the operation of sections 444H and 445H of the Act.  **(b) Facts**  The Company was run by a single director, Mr Theodore Poteri. He and his wife, Ms Sandra Driscoll, and the Applicant, were all unsecured creditors of the Company. The Company was placed under voluntary administration in late 2009, at which time a number of preferential payments, unreasonable director related transactions and suspected offences against the Act came to light.  Shortly after his appointment, the Administrator received a proposal for a DOCA from a third party (who was not identified in her Honour's judgment). Under this proposal, the third party agreed to contribute $20,000 to the administration if the Company's creditors agreed to approve the DOCA. This DOCA was taken to include the standard terms prescribed by section 444A(5) of the Act, including terms providing for the full discharge of the Company's debts and the extinguishment of creditor claims. Under the proposal, Mr Poteri and Ms Driscoll would be excluded from receiving dividends issued under the DOCA, but would retain their voting rights. The DOCA also gave priority to the Administrator's fees ahead of the claims of admitted creditors.  In his formal statement of advice to creditors, the Administrator recommended against the DOCA, advising creditors that their interests would best be served by winding up the Company. Nevertheless, the Company's creditors approved the DOCA by a vote of 4-1 "on the voices", with Mr Poteri, Ms Driscoll and two small creditors voting in favour of executing the DOCA, and the Applicant voting against. The DOCA was executed on 23 October 2009 and terminated by performance on 27 October 2009. Under the terms of the DOCA, creditors' claims against the Company were extinguished when performance occurred. All of the funds collected by the Administrator were applied to his fees, and the admitted creditors received no dividend.  The Applicant applied for relief under the Act in November 2009. The Applicant submitted that the passing of the creditors' resolution in favour of the DOCA was detrimental to the Company's creditors as a whole, as well as being oppressive or unfairly prejudicial to, or unfairly discriminatory against, the Applicant. The Applicant also contended that the resolution approving the DOCA would not have been passed if Ms Driscol, allegedly a related creditor of the Company, had not voted.  The court ordered that ASIC be informed of the action commenced by the Applicant, and the regulator subsequently intervened to assist the Court on questions of law. In its submission, ASIC expressed its opinion that the DOCA was detrimental to creditors as a whole, and appeared to be designed to protect the Company's director from susceptibility to voidable transactions.  **(c) Decision**  **(i) Cause of action**  Justice Wilson began her consideration of the Applicant's case by clarifying the source of the Court's power to grant relief. She noted that, as the DOCA had been terminated "by performance," the Court had no power to terminate it under section 445D of the Act. She therefore had to consider whether the Court could set aside, rather than terminate, the DOCA. Accordingly, her Honour proceeded to examine sections 600A and 447A of the Act.  **(ii) Application of section 600A**  Justice Wilson found that, if applicable, section 600A was broad enough to allow her to grant the relief sought. Section 600A gives the court power to intervene where the result of a vote on a creditor resolution to enter a DOCA or wind up a company would have been different had the vote of a related creditor been disregarded, in situations where the resolution is contrary to the interests of creditors as a whole or unreasonably prejudicial to the creditors who voted against it.  Her Honour adopted a broad reading of the standing requirements under section 600A of the Act, finding that the section's reference to a 'creditor' should be read as referring to a party who was a creditor at the time the resolution was passed. Accordingly, even though the Applicant was no longer a creditor due to the extinguishment of its claims under the DOCA, it still had standing to make an application under section 600A as it was a creditor of the Company at the relevant time. She also noted that Mr Poteri and Ms Driscoll were related creditors within the meaning of the Act.  However, Justice Wilson found that the resolution had not been determined by the vote of a related creditor in this case. Her Honour noted that even if Mr Poteri and Ms Driscoll's votes had been disregarded, the resolution would still have carried 2-1 "on the voices." The Applicant had argued that, absent the votes of Mr Poteri and Ms Driscoll, it would have had reason to demand a poll, as there would have been a majority in favour of the DOCA in number only, not in value, and the administrator, as Chairman, would have been called upon to exercise a casting vote. Her Honour rejected this argument, and held that the Court must focus on the way the meeting was actually conducted.  Her Honour noted that if her decision on this point was wrong, then she would have no difficulty in finding that the passing of the relevant resolution was contrary to the interests of the creditors as a whole and was unreasonably prejudicial to the interests of the Applicant, and that orders should be made setting aside the resolution and the DOCA and that the Company be wound up.  **(iii) Application of section 447A**  Justice Wilson began her discussion of section 447A by noting that it allowed an application to be brought not only by creditors, but also by 'any other interested person'. In her Honour's view, this clearly included the Applicant.  Her Honour then went on to discuss the scope of the power conferred by section 447A, which allows a court to "make such order as it thinks appropriate" about how Part 5.3A of the Act is to operate in relation to a particular company. Citing the High Court case of *Australasian Memory Pty Ltd v Brien* (2000) 200 CLR 270, Justice Wilson ruled that section 447A conferred a broad power that would ordinarily be sufficient to grant the relief sought. However, because the DOCA in this case had been terminated by performance there were several issues to be addressed before section 447A could be invoked.  The first issue was that the Applicant was seeking an order to set aside the DOCA ab initio. This was an issue because *Australasian Memory Pty Ltd v Brien* left open the possibility that the power under section 447A of the Act cannot be exercised where granting relief would be inconsistent with rights that had accrued in the period between the termination of the DOCA and the application for relief. Such rights could arise if shares in the company were traded and the director resumed management of the company and dealt with assets. Justice Wilson noted that in the case before her receivers and managers had been appointed to the company even before the resolution to execute the DOCA had been passed, and those receivers and managers were still operating up to the time of judgment. Accordingly, her Honour considered that it was unlikely that the director had incurred any obligations on behalf of the Company after the receivers had been appointed, or that any rights had accrued since the DOCA had been put into effect.  The second issue related to the release of creditors' claims. Under the DOCA, the creditors' claims against the Company were released upon completion, and section 445H of the Act provides that the termination or avoidance of a DOCA does not affect the previous operation of the deed. However, section 444H of the Act states that a release is only effective to the extent that a creditor is bound by the deed. In combination, these provisions raised the question of whether a release would be effective if a DOCA was set aside ab initio. If the release remained in place, there would be no utility in setting aside the DOCA as the Applicant would still have no claim.  Justice Wilson noted that the inter-relationship between sections 444H and 445H of the Act is unclear, and that there was a risk that, by force of section 445H, the release of creditors' claims under the DOCA is not affected by that deed being set aside. Her Honour resolved this question by exercising the Court's power under section 447A to modify the operation of the sections 444H and 445H in terms that specifically overturned the release of debts in cases where the DOCA was set aside by court order.  On the basis of these findings Justice Wilson ordered that the creditors' resolution and the DOCA be set aside ab initio, that the company be wound up and that the operation of sections 444H and 445H in relation to the Company be modified as described above.  [etailed Contents](http://www.law.unimelb.edu.au/bulletins/152%20April%202010.htm%23h5)  **5.2 Requirements of summonses to produce documents issued under section 596B of the Corporations Act**  (By Dean Bao, DLA Phillips Fox)  Bill Express Limited (In Liquidation) [2010] VSC 101, Supreme Court of Victoria, Davies J, 31 March 2010  The full text of this judgment is available at:  [http://cclsr.law.unimelb.edu.au/judgments/states/vic/2010/march/2010vsc101.htm](http://cclsr.law.unimelb.edu.au/judgments/states/vic/2010/march/2010vsc101.htm" \t "_new)  or  [http://cclsr.law.unimelb.edu.au/judgments/search/advcorp.asp](http://cclsr.law.unimelb.edu.au/judgments/search/advcorp.asp" \t "_new)  **(a) Summary**  This case involved an appeal by the applicants against the decision of Gardiner AsJ, who rejected their application to discharge or vary summons for production of documents under section 596B of the [Corporations Act 2001 (Cth)](http://my.lawlex.com.au/default.asp?cid=56482&itid=0&ntid=0&nid=&alpha=&alphaid=&jurid=&ihl=&nhl=&fp=&top=exp&nav=col&pact=coredoc" \t "_default) (Corporations Act).  The applicants were ordered to attend court for examination about the examinable affairs of Bill Express Limited (in liquidation) (Bill Express) and its subsidiaries, and to produce books and records set out in the schedule of the summonses. Their application for discharge or variation of the production orders was dismissed as it was concluded that they were not too wide or oppressive. The first instance decision was upheld by Davies J and the appeal dismissed.  **(b) Facts**  Gardiner AsJ made orders on the application of the liquidators of Bill Express for the issue of summonses under section 596B of the Corporations Act. Pursuant to these summonses:   * The first applicant was required to produce "all books and records relating to the affairs of Bill Express Limited (In liquidation)...between the period 1 January 2005 and 8 July 2008, as are in [his] possession, custody or under your control." * The second applicant was required to produce "all books and records relating to the affairs of Bill Express Limited (In liquidation)...from the 2 years ending 8 July 2008, as are in [his] possession, custody or under your control."   The applicants applied for the discharge or variation of the production orders on the grounds that they were too wide and oppressive. This was dismissed by Gardiner AsJ. Both applicants appealed this initial decision, and further contended that the summonses were 'beyond power' on the following grounds:   * The documents described as documents 'relating to' the 'examinable affairs' of a corporation did not meet the statutory criterion that they be 'specified''; * A summons that requires production of documents relating to examinable affairs beyond the subject matter of the examination was outside the power conferred in section 596B of the Corporations Act; * The liquidators were using the summons as a fishing expedition to identify documents beyond the scope of the examination; and * The summons was too wide as it required the examinee to exercise judgment about the documents which fell within the ambit of the summons.   **(c) Decision**  Davies J held that the summonses were not beyond power. Since there was no limitation placed on the subject matter of the examination, other than that it must be about a corporation's examinable affairs, an order for the production of documents in relation to the affairs of a corporation was within the power of the court. Davies J reasoned that the purpose of Part 5.9 of the Corporations Act was to aid liquidators in carrying out their duties, and hence it is an inquisitorial process. Therefore, it is inherent in that procedure that there is the possibility that an examination may involve questions of a fishing nature. Accordingly, it was proper use of the examination process for an examiner to explore what information the examinee does have.  Davies J further concluded that the summonses were not too wide or oppressive. The liquidators were attempting to find out what documents the applicants held. Therefore, they were entitled to require the production of all such documents in the possession of the applicants. The fact that this was onerous was no reason for the applicants to be relieved from the burden of complying with the summons since it conformed with the statutory requirements of section 596D of the Corporations Act.  It was argued that the documents were not sufficiently specified as the applicants had to make a judgment about whether documents related to the 'affairs' of the company. Davies J reasoned that orders made under section 596B of the Corporations Act must identify the books and records required to be produced with sufficient clarity in order to enable the recipient to know what documents came within the terms of the summons, and to form a reasonable view as to what must be produced in order to comply with the summons. Davies J concluded that the summons were reasonably clear as to what documents were to be produced.  The evidence before the court showed that the examinees were familiar with the operations, activities and books and records of Bill Express. This evidence was not contradicted, and hence the applicants were capable of identifying those documents that fell within the description of 'books and records'.  Further, Davies J concluded that the words 'owed or owing' were capable of sensible and clear meaning. The second applicant, on the un-contradicted evidence of the liquidator, maintained the books and records of Bill Express and it would be reasonably inferred that he had detailed knowledge of the company's books. Accordingly, the second applicant would be aware of the documents he would have to produce to meet his obligations.  Davies J dismissed the appeal.  [etailed Contents](http://www.law.unimelb.edu.au/bulletins/152%20April%202010.htm%23h5)  **5.3 When is a creditor a shadow director of its debtor?**  (By Michael Power, Mallesons Stephen Jaques)  Buzzle Operations Pty Ltd (In Liq) v Apple Computer Australia Pty Ltd [2010] NSWSC 233, New South Wales Supreme Court, White J, 30 March 2010  The full text of this judgment is available at:  [http://cclsr.law.unimelb.edu.au/judgments/states/nsw/2010/march/2010nswsc233.htm](http://cclsr.law.unimelb.edu.au/judgments/states/nsw/2010/march/2010nswsc233.htm" \t "_new)  or  [http://cclsr.law.unimelb.edu.au/judgments/search/advcorp.asp](http://cclsr.law.unimelb.edu.au/judgments/search/advcorp.asp" \t "_new)  **(a) Summary**  This judgment clarifies the law on shadow directors, and gives valuable practical guidance to creditors of distressed companies.  Apple Computer Australia Pty Ltd ('Apple') was a secured creditor of its distributor, Buzzle Operations Pty Ltd ('Buzzle'). Buzzle became insolvent. Buzzle's liquidator sued Apple and its Finance Director, James Likidis, on the basis that they were shadow directors of Buzzle under section 9 of the [Corporations Act 2001 (Cth)](http://my.lawlex.com.au/default.asp?cid=56482&itid=0&ntid=0&nid=&alpha=&alphaid=&jurid=&ihl=&nhl=&fp=&top=exp&nav=col&pact=coredoc" \t "_default) ("the CA").  The court rejected these claims. It found that a third party can use its commercial position to make demands on a distressed company without thereby becoming a shadow director.  Justice White held that for a creditor to be a shadow director:   * they must convey 'instructions or wishes' to the directors, not other executives; * they must instruct the directors to act in their capacity as directors of that company; * the instructions must be conveyed to a 'governing majority' of directors; and * the instructions must cause the directors to so act.   The case shows that a creditor of a distressed company can have a high degree of involvement in the company's affairs without being liable as a shadow director, so long as it avoids making instructions of this kind. This is likely to be of assistance to creditors of distressed companies who want to work with the debtor company to try to keep it afloat.  **(b) Facts**  Buzzle was incorporated on 3 July 2000, with the intention of merging six companies which distributed Apple's products ('the Resellers'). Apple held a charge over the Resellers' stock, so its consent to the merger was required. Apple and Mr Likidis therefore met regularly with the Resellers, advising them how to proceed and imposing conditions on Apple's approval of the merger. The merger was completed on 14 September 2000, and Apple took a charge over Buzzle's assets.  It gradually became apparent that the merged business was not viable. According to White J, Buzzle was insolvent by at least 6 November 2000. By December this became apparent to Apple, and Mr Likidis again took an active role in managing Buzzle. The extent of that involvement was disputed at trial, but Justice White ultimately found that Likidis had gone so far as to interview and approve the appointment of new staff, who reported directly to him. Apple also required Buzzle to enter into a Payment Deed whereby it restricted its ability to assume debt and deal with cash flow in future.  Despite this involvement, on 22 January 2001, Apple wrote a letter to Buzzle disclaiming any involvement in 'corporate decision making' and affirming that Buzzle's directors 'have the ultimate responsibility for all decisions'. Apple made Buzzle sign this, by threatening to withdraw its support.  On 31 March 2001 Apple appointed receivers to Buzzle. On 15 February 2002, an order was made for Buzzle to be wound up, and liquidators were appointed. The liquidators sued Apple and Mr Likidis, making four claims:   * Apple was a shadow director of Buzzle. Therefore, certain payments made to Apple were voidable under section 588FE of the CA, and Buzzle was entitled to compensation for insolvent trading under sections 588G and 588M of the CA. * Apple was an 'officer' of Buzzle under section 9 of the CA. Therefore, Apple's charge over Buzzle was void pursuant to section 267(1) of the CA, and the receivers were liable for trespass.   **(c) Decision**  Justice White rejected all of the plaintiffs claims.  **(i) Apple was not a shadow director, so the payments were not voidable and the defendants were not liable for insolvent trading**  Section 9 of the CA says that a person is a shadow director if 'the directors of the company or body are accustomed to act in accordance with the person's instructions or wishes.'  His Honour began by affirming that a company can be a shadow director, including for the purposes of section 588G. He then went on to consider the proper interpretation of this clause, making the following important observations:   * the shadow director need not control all aspects of decision-making; * the shadow director need not control all board members: only a 'governing majority' (at [235]); * there must be a 'causal connection' between the shadow director's instructions or wishes and the actions of the board (at [244-7]); * 'accustomed to act' denotes habitual compliance over a period of time (at [248]); and * advice from a shadow director can constitute 'instructions or wishes' (so long as that advice is not given in the proper performance of functions attaching to their professional capacity) (at [249]).   Perhaps the most important part of White J's judgment is his insistence that the instructions of the shadow director must be made to the directors of the company (not executive or management personnel), in their capacity as directors (not a managerial or other capacity). This led White J to find the following:   * the instructions must be conveyed to the directors: not to the company's executive officers or management (at [250]-[276]); * the instructions must relate to the conduct of that company's affairs (not the affairs of some other, related business) (at [282]-[285]); * instructions made to directors before they were actually directors of that company are not relevant (at [242]); and * commercial demands made on directors by third parties do not make them shadow directors, because the final decision still rests with the directors (at [282]-[285]).   This last point is perhaps the most interesting part of the judgment. Justice White said that although "third parties having commercial dealings with a company…are able to insist on certain terms…[they] are not thereby to be treated as shadow directors…" This is because "to insist on such terms as a commercial dealing between a third party and the company is not ipso facto to give an instruction or express a wish as to how the directors are to exercise their powers. Unless something more intrudes, the directors are free and would be expected to exercise their own judgment…" (at [243]).  This point is interesting not only because of its practical importance for creditors of distressed companies, but also because it leaves so many questions unanswered. What does it mean for a director of a distressed company, left at the mercy of its creditor, to be 'free to decide'? What is the 'something more' that is required to make a strong creditor a shadow director?  For future cases, it is important to note how rigidly White J approached the question of shadow directorship. Despite the defendants' high degree of involvement in Buzzle's affairs, his Honour applied a very strict test for shadow directorship:   * an instruction or wish must have been conveyed (see [319] and [325]); * to a 'governing majority' of directors (no one else); * in their capacity as directors of that company; * which caused them to follow those instructions; and * which was more than just 'commercial negotiation at arms length'.   Applying this analysis to the facts of the case, White J considered 17 instructions which the plaintiffs said made the defendants shadow directors, and found that all instances failed to meet one or more of the criteria mentioned above.  **(ii) Apple was not an 'officer', so the charge is valid and the receivers did not trespass**  Justice White held that the charge was valid, because Apple was neither an 'officer' of Buzzle nor a 'person associated' with an officer of Buzzle.  There are two limbs to the definition of 'officer' in section 9. The first is a person 'who makes, or participates in making, decisions that affect the whole, or a substantial part, of the business of the corporation.' His Honour considered 12 decisions which Apple was said to have made or participated in. He rejected the plaintiff's arguments on the basis that:   * Apple used its power to refuse consent to the merger to extract terms favourable to it, but that does not amount to 'participating in' or 'making' decisions for Buzzle; and * at any rate, many of those decisions did not affect a 'substantial part of the business' of Buzzle.   The second limb of the definition is 'a person who has the capacity to affect significantly the corporation's financial standing'. His Honour read this limb narrowly, following *ASIC v Citigroup Global Markets Australia Pty Ltd* (No 4) (2007) 160 FCR 35, and found that it meant a person involved in 'management', who 'is involved in policy making and decisions that affect the whole or a substantial part of the business of the corporation.' (at [126]).  Finally, his Honour rejected the argument that Apple was an 'associate' of Buzzle, finding that Apple could not be found to have 'acted in concert' with Buzzle merely by executing a transaction together. It was therefore unnecessary to decide whether Apple took steps to enforce the charge within 6 months of its creation (although His Honour hinted that, merely by appointing investigating accountants, it did not).  [etailed Contents](http://www.law.unimelb.edu.au/bulletins/152%20April%202010.htm%23h5)  **5.4 Penalties for director drafting and authorising misleading and deceptive statements made to the ASX**  (By Jiayue Li, DLA Phillips Fox)  Australian Securities and Investments Commission v Citrofresh International Ltd (No 3) [2010] FCA 292, Federal Court of Australia, Goldberg J, 29 March 2010  The full text of this judgment is available at:  [http://cclsr.law.unimelb.edu.au/judgments/states/federal/2010/march/2010fca292.htm](http://cclsr.law.unimelb.edu.au/judgments/states/federal/2010/march/2010fca292.htm" \t "_new)  or  [http://cclsr.law.unimelb.edu.au/judgments/search/advcorp.asp](http://cclsr.law.unimelb.edu.au/judgments/search/advcorp.asp" \t "_new)  **(a) Summary**  This proceeding related to whether a disqualification order and pecuniary penalty should be ordered against Mr Ravi Amrit Narain (the second defendant).  In an earlier proceeding (*Australian Securities and Investments Commission v Citrofresh International Ltd* (No 2) [2010] FCA 27), Goldberg J found that Mr Narain, the managing director and the chief executive officer of Citrofresh International Ltd ('CIL') at the relevant time, had breached his statutory duty of care and diligence by causing CIL to engage in conduct in relation to a financial product that was misleading and deceptive in contravention of section 1041H(1) of the [Corporations Act 2001 (Cth)](http://my.lawlex.com.au/default.asp?cid=56482&itid=0&ntid=0&nid=&alpha=&alphaid=&jurid=&ihl=&nhl=&fp=&top=exp&nav=col&pact=coredoc" \t "_default) ('the Act').  Goldberg J ordered that Mr Narain:   * be disqualified from managing corporations for seven years commencing from the date of the court order; and * pay a pecuniary penalty to the Commonwealth of $20,000.   **(b) Facts**  On 27 September 2005, Mr Narain authorised and procured CIL to make a statement to the Australian Stock Exchange Ltd ('ASX') which falsely represented that CIL's Citrofresh product provided a solution which controlled and prevented HIV, human influenza, SARS and human rhinovirus. Later on the same day, CIL requested a trading halt and in response to an ASX query made a further statement on 29 September 2005 that Citrofresh was not a vaccine and was not a cure for HIV.  These events created substantial fluctuations in the price of CIL shares and a significant increase in the volume of CIL shares traded on the ASX during the period between 27 and 29 September 2005.  **(c) Decision**  Goldberg J stated that Mr Narain's breach of his duty of care and diligence under section 180(1) of the Act constituted a breach of a civil penalty provision which empowered the court to make a disqualification order and/or impose a pecuniary penalty. The fact that section 1041H(1) was not of itself a civil penalty provision did not affect the court's power to make a disqualification order and/or pecuniary penalty order against Mr Narain for breaching his duties as a director as result of causing CIL to contravene section 1041H.  **(i) Factors leading to the making of the disqualification order**  In light of the relevant authorities, his Honour confirmed that when the court has to determine whether or not to impose a disqualification order and a pecuniary penalty, the court's practice is to consider the issue of the disqualification order first.  Section 206C(1) of the Act provides the court with a broad discretion to disqualify a person from managing corporations for a period that the court considers appropriate if a declaration has been made under section 1317E that the person has contravened a civil penalty provision and the court is satisfied that the disqualification is justified.  Section 206C(2) further provides that in determining whether disqualification is justified, the court may have regard to the person's conduct in relation to the management, business or any other property of any corporation, as well as any other matters the court considers appropriate.  Goldberg J held that it was appropriate for Mr Narain to be disqualified from managing corporations for a period of seven years after taking into account a number of considerations as distilled from the key propositions in leading cases. The court rejected the claims made by Mr Narain that Mr Narain's inexperience, reliance on purported "experts", lack of dishonesty in making the statement and his not being motivated by personal gain exculpated Mr Narain's conduct.  Goldberg J held that Mr Narain's contravention of his statutory duty of care and diligence was serious. The release of the misleading and deceptive statement had serious consequences for CIL and investors who bought CIL shares due to the statement. Despite the later correction of the statement, his Honour noted that the damage had already been done. Additionally, CIL had incurred more than $150,000 in legal costs to defend the proceedings related to the making of the statements.  Although others were involved in the preparation and drafting of the statement, Mr Narain was found to be 'directly and intimately involved' in the preparation and drafting of the statement released to the ASX.  Goldberg J stated that there was no justification for the statement which was made to the ASX. In addition, it was not reasonable for Mr Narain to rely on the two reports from his advisors as the advisors did not have technical or scientific qualifications in relation to infectious diseases which warranted or justified Mr Narain relying upon them for drafting the statement.  Goldberg J held that Mr Narain's inexperience did not excuse him from exercising the required degree of skill and care required of a company director, especially one who was a managing director and chief executive officer.  Goldberg J stated the while the circumstances which led to Mr Narain's prior disqualification on 17 November 1998 for three years were different, the fact that the prohibition terminated less than four years prior to the incidents in this proceeding demonstrated that the prohibition was clearly insufficient to ensure that Mr Narain would discharge his duties as a director with the required degree of care and diligence.  Furthermore, his Honour considered that general deterrence had not been achieved by the fact that Mr Narain was automatically disqualified from managing corporations due to being an undischarged bankrupt, as there was no causal relationship between him releasing the statement to the ASX and his bankruptcy.  Mr Narain's failure to provide evidence of any remorse or contrition or personal hardship flowing from disqualification also weighed in favour of a significant period of disqualification.  Taking all these factors into account, Goldberg J held that the disqualification order operated as a specific deterrent on Mr Narain in respect of any future conduct by him as a director of a corporation.  Goldberg J also stated that imposing a significant period of disqualification served the public interest as it signalled to other directors that they must take their duties and responsibilities as directors very seriously.  The disqualification would operate from the date of the order, even though Mr Narain would be disqualified from becoming a director of a corporation due to his bankruptcy until January 2011 in any event.  **(ii) Imposition of pecuniary penalty in addition to disqualification order**  The court may impose a pecuniary penalty of up to $200,000 in respect of a relevant contravention if the contravention materially prejudices the interests of the corporation or its members, materially prejudices the corporation's ability to pay creditors or is serious.  Taking into account principles drawn from the leading cases, Goldberg J acknowledged that the consequences of any disqualification order imposed is a relevant factor in determining the imposition of a pecuniary penalty. It was acknowledged that the disqualification order imposed did have significant consequences for Mr Narain. Nevertheless, the seriousness of Mr Narain's contravention and the lack of mitigating factors resulted in Goldberg J imposing a pecuniary penalty of $20,000 against Mr Narain.  Goldberg J was satisfied that the price fluctuations had materially prejudiced CIL and its members and the misinformation of the market was serious. Goldberg J also confirmed that Mr Narain's inexperience of managing corporations and his deference to advisors did not operate to excuse his conduct. By being intimately involved in the preparation of the announcement when he was 'out of his depth', Mr Narain abrogated the duty he owed to CIL and its members.  Additionally, his Honour confirmed that the pecuniary penalty imposed was not a provable debt in the bankruptcy and therefore Mr Narain would still be liable to pay the penalty once he was discharged from his bankruptcy.  [etailed Contents](http://www.law.unimelb.edu.au/bulletins/152%20April%202010.htm%23h5)  **5.5 Reading down of an aggressive takeover defence fee arrangement**  (By Alex Bowen, Mallesons Stephen Jaques)  JP Morgan Australia Ltd v Consolidated Minerals Ltd [2010] NSWSC 100, Supreme Court of New South Wales, Hammerschlag J, 18 March 2010  The full text of this judgment is available at:  [http://cclsr.law.unimelb.edu.au/judgments/states/nsw/2010/february/2010nswsc100.htm](http://cclsr.law.unimelb.edu.au/judgments/states/nsw/2010/february/2010nswsc100.htm" \t "_new)  or  [http://cclsr.law.unimelb.edu.au/judgments/search/advcorp.asp](http://cclsr.law.unimelb.edu.au/judgments/search/advcorp.asp" \t "_new)  **(a) Summary**  Consolidated Minerals ("CM") engaged JP Morgan to advise it on takeover defences. The engagement provided for various fees which depended on the initial and final offer prices in the event that an offer proceeded to completion.  There was a bidding war for CM with three participants, fuelled by increases in the price of manganese. The offer which was finally accepted was more than double the price of the first offer which was received.  In light of the huge increase in bid prices, there was a dispute about the way the fees should be calculated. JP Morgan claimed fees of $50 million. CM paid $20 million, purportedly in satisfaction of the claim.  In essence, the dispute was about whether JP Morgan had earned the huge fees claimed. The contract referred to 'the achievement of additional value to the company's shareholders', but the increase in price was not necessarily referable to JP Morgan's efforts, in circumstances where the bidding was aggressive and the relevant commodity price was rising sharply.  The Court's decision was based on detailed interpretation of the contract. The Court adopted conservative interpretations which resulted in a smaller calculation of fees, which conveniently added up to about $20 million. JP Morgan was also found not to be entitled to defence response fees for "defending" the bids which had been rejected when higher bids were made.  **(b) Facts**  CM was a takeover target and retained JP Morgan to advise it on its takeover defence. An engagement agreement provided for various fees payable to JP Morgan. The main fees payable if an offer proceeded to completion were a Base Defence Response Fee and an Incentive Fee.  The Base Defence Response Fee was 0.75% of the Transaction Value, plus GST.  The Incentive Fee was 3% of any increase in offer price for the first 25% above the initial offer price, and 5% of any increase thereafter.  Three potential acquirers made numerous bids for CM shares over the course of almost a year. The first bid was for $2.08 in cash and shares, and the ultimate successful bid, made by Palmary, was for $5 per share.  One of the reasons why the price went up so much over the bidding period was a dramatic increase in the price of manganese. CM's board made numerous recommendations to shareholders to accept offers which were then withdrawn in favour of higher offers. The board ultimately recommended acceptance of the Palmary offer.  Following the acceptance of the final offer, there was a series of communications between the parties about the amount of the fee. JP Morgan generated an invoice for $50 million. CM's board approved a payment of $20 million.  CM sent JP Morgan a cheque for $20m, purportedly in satisfaction of the entire claim. The cheque was cashed, but JP Morgan responded (by overnight courier which arrived the day after the cheque was cashed) that it did not accept that the payment was in satisfaction of the entire claim.  **(c) Decision**  **(i) Calculating transaction value**  The Base Defence Response Fee was to be 0.75% of the Transaction Value. Transaction Value was defined as 'the total proceeds and other consideration paid… in connection with the Offer'.  In dispute was whether the Transaction Value should include the value of the pre-bid stake acquired by Palmary Enterprises (not the same company as Palmary, who successfully bid for CM); and whether it should include the value of CM's net debt at the time of acquisition.  The court found that the money paid by Palmary Enterprises to acquire the pre-bid stake was not paid in connection with the particular offer ultimately taken up by the other shareholders. It was not sufficient that the pre-bid stake was acquired in anticipation of an offer being made.  CM's net debt was also found not to be part of the consideration paid in connection with the offer. While Palmary presumably took CM's debts into account in determining its offer price, it did not undertake liability in its own right for them. This is a consequence of the separation of legal personality between a company and its shareholders.  **(ii) Measuring the increase in offer price**  The Incentive Fee was to be calculated from 'any increase in the Offer price… above the initial Offer Price which was communicated to the Company'.  The question was whether the relevant initial offer was the first offer from the successful bidder, Palmary, or the first offer that was received from any bidder, which was much lower. The court interpreted the relevant clause to refer to offers by the same party.  The Incentive Fee was intended to recognise 'the achievement of additional value to the Company's shareholders'. The commercially sensible operation of the clause was one in which JP Morgan was rewarded for discharging its duty to obtain the best possible price for its client.  JP Morgan was already going to be rewarded for the fact that there was a successful offer, by way of the Base Defence Response Fee. The Incentive Fee was therefore to provide an extra incentive if the price of the offer was increased from its starting point.  The value of the offer was (impliedly) to be obtained by multiplying the price by the number of shares. The shares in the pre-bid stake were included in this calculation, because there was no reference to Transaction Value in the clause, and anyway the shares were actually acquired under the offer because they were previously held by a different Palmary company.  The court's decision to measure the change in offer price from the first Palmary offer, and not the original lower offer from another bidder, significantly reduced the size of the Incentive Fee payable.  **(iii) Purported settlement of claim**  CM sent a cheque for $20 million 'in full and final settlement of this matter'. JP Morgan banked the cheque but replied by letter received the next day that it did not accept the cheque as a full and final settlement.  The terms on which the cheque was offered were not clear enough to establish that acceptance of the cheque constituted a binding agreement that JP Morgan would give up its claims. If it was an offer, it specified no manner of acceptance and JP Morgan would not have accepted it because it immediately sent a letter stating that.  **(d) Result**  The calculation of the fees owed on the Court's interpretation, subject to adjustments of arithmetic, came to just under $20 million. As $20 million had already been paid, both claims were dismissed with costs.  [etailed Contents](http://www.law.unimelb.edu.au/bulletins/152%20April%202010.htm%23h5)  **5.6 Commencing proceedings against a company in liquidation and access to inspect its books**  (By Steven Grant, Minter Ellison)  Snelgrove v Great Southern Managers Australia Ltd (in liq) (receivers and managers appointed) [2010] WASC 51, Supreme Court of Western Australia, Le Miere J, 17 March 2010  The full text of this judgment is available at:  [http://cclsr.law.unimelb.edu.au/judgments/states/wa/2010/march/2010wasc0051.htm](http://cclsr.law.unimelb.edu.au/judgments/states/wa/2010/march/2010wasc0051.htm" \t "_new)  or  [http://cclsr.law.unimelb.edu.au/judgments/search/advcorp.asp](http://cclsr.law.unimelb.edu.au/judgments/search/advcorp.asp" \t "_new)  **(a) Summary**  This case concerns the circumstances in which leave will be granted to commence proceedings against a company in liquidation and to inspect its books in order to determine whether the plaintiffs' proposed claims are covered by an insurance policy held by the defendant company.  **(b) Facts**  This case concerned two proceedings against Great Southern Managers Australia Limited (GSMAL). Each of the plaintiffs is, or was, a member of Great Southern 2006 Beef Cattle Project or Great Southern 2007 Beef Cattle Project, each being a managed investment scheme registered under the [Corporations Act 2001 (Cth)](http://my.lawlex.com.au/default.asp?cid=56482&itid=0&ntid=0&nid=&alpha=&alphaid=&jurid=&ihl=&nhl=&fp=&top=exp&nav=col&pact=coredoc" \t "_default) (the Act). GSMAL was the responsible entity of a managed investment scheme under Chapter 5C of the Act, namely the 2006 Great Southern Beef Cattle Project (Scheme). Administrators were appointed to GSMAL on 16 May 2009 and receivers and managers were appointed on 18 May 2009. At the second meeting of creditors held on 19 November 2009 the creditors resolved that GSMAL be wound up.  The plaintiffs sought to:   * commence proceedings against GSMAL and directors of GSMAL for damages or compensation arising from the conduct of the proposed defendants resulting in the plaintiffs exchanging their interest in the Scheme for shares in Great Southern Ltd (GSL); and * inspect the books of GSMAL to determine whether their proposed claims against GSMAL and the directors are covered by insurance held by GSMAL.   As GSMAL was in liquidation the plaintiffs could not commence either set of proceedings without the leave of the court under section 500(2) of the Act. The plaintiffs sought:   * leave to commence proceedings for the inspection of the books of GSMAL under section 247A of the Act; * an order authorising the plaintiffs' solicitors to inspect the books of GSMAL; and * leave to commence proceedings against GSMAL for damages or compensation.   Each of the plaintiffs invested an amount in the Scheme and acquired a number of droves, or groups of cattle, by investment in the Scheme. Cameron Rhodes and Phillip Butlin (the common directors) were directors of GSMAL and directors of GSL. Steven Cole, Murray Colvin and Robert Jenkins (the independent directors) were directors of GSMAL but not directors of GSL. Each of GSMAL and Great Southern Cattle Managers Pty Ltd (GSCM) was a wholly owned subsidiary of GSL. Great Southern Cattle Holdings Pty Ltd (GSCH) was a wholly owned subsidiary of GSMAL. GSL, GSMAL, GSCM and GSCH formed part of the Great Southern Group of Companies (the Great Southern Group).  The directors caused GSMAL by notice of meeting dated 23 October 2008 to convene a meeting of Scheme Members on 1 December 2008 (the Meeting) to consider two motions. The first motion was to pass a special resolution (the First Resolution) to amend the Constitution by inclusion of clause 34A to enable the responsible entity to propose an arrangement to Scheme Members which (if supported by the Second Resolution) would become binding on all Scheme Members. If the First Resolution was passed, the second motion was to pass a resolution (the Second Resolution) to approve the arrangement defined in clause 7.3 of the Explanatory Memorandum for the Meeting proposed by GSL, by which each Scheme Member would:   * agree with GSMAL to terminate the Scheme Member's Lease Management and Agistment Agreement for the Great Southern Beef Cattle Project; * agree to sell the Scheme Member's Progeny to GSCM; and * agree to assign to GSCM all entitlements of the Scheme Member to receive distributions from the Proceeds Fund;   in exchange for which GSL would issue to the Scheme Member fully paid shares in the capital of GSL (GSL Shares), the number of which would depend on the volume weighted average price of GSL Shares during a reference period.  The common directors and the independent directors also convened meetings of members of the other schemes to consider resolutions in relation to each of those schemes in materially identical terms that the First Resolution and the Second Resolution had on the Scheme.  The Meeting was adjourned on 1 December 2008 until 19 January 2009. At the adjourned meeting, the First Resolution and Second Resolution were passed. At the adjourned meetings of members of the other schemes, the members of those schemes voted against the equivalent resolutions. The plaintiffs stated that the effective operation of the Scheme ended by the lodgement with ASIC of the modification of the Constitution on 27 January 2009 and the issue of shares in GSL to Scheme Members on 4 February 2009.  The plaintiffs alleged several contraventions of duty by GSMAL and the common and independent directors (by way of their involvement) including:   * the duty imposed on it by section 601FC(1)(b) to exercise the degree of care and diligence that a reasonable person would exercise if they were in GSMAL's position; * the duty imposed on it by section 601FC(1)(c) of the Act to act in the best interests of the Scheme Members and to give priority to the interests of the Scheme Members over the interests of GSMAL if there was a conflict between those interests; and * the duty imposed on it by section 601FC(1)(d) of the Act to treat all Scheme Members equally.   The plaintiffs alleged that by reason of those matters they suffered loss and damage being the value of each member's assets on the basis that the GSL Shares issued to Scheme Members were at the time of, and all times after, the Adjourned Meeting, worthless once GSL and the entire Great Southern Group went into administration on 16 May 2009 and into receivership on 18 May 2009.  Alternatively, the plaintiffs argued that the loss and damage they suffered was the difference between the value of each member's assets and the value of GSL Shares received by each plaintiff.  **(c) Decision**  **(i) Proposed application for inspection of books**  Section 247A(1) provides that on application by a member of a registered managed investment scheme, the Court may make an order:   * authorising the applicant to inspect books of the company; or * authorising another person (whether a member or not) to inspect books of the company on the applicant's behalf.   The court may only make the order if it is satisfied that the applicant is acting in good faith and that the inspection is to be made for a proper purpose. The plaintiffs believed that GSMAL had an insurance policy or policies which may respond to the plaintiffs' claims and wanted to inspect GSMAL's books to confirm that and ascertain the extent of the insurance cover.  The liquidators submitted that the plaintiffs' application for leave to commence proceedings for the inspection of the books of GSMAL and the application for an order authorising the plaintiffs' solicitors to inspect the books of GSMAL should be dismissed on three grounds:   * The allegations upon which the plaintiffs' alleged causes of action were founded, namely the loss by the plaintiffs of their relevant rights in connection with the operation of the Scheme in exchange for a shareholding in GSMAL of inferior value, were irreconcilably inconsistent with the plaintiffs being members of the Scheme, which is a condition for granting an order authorising the inspection of the books of GSMAL under section 247A. * The insurance documents are not books of the Scheme. * In any event the discretion under section 247A should not be exercised so as to permit the plaintiffs to have access to contracts of insurance and communications or records of communications between GSMAL and its insurers.   These submissions were directly relevant to whether leave should be granted to commence proceedings against GSMAL.  **(ii) Application to commence proceedings against a company in liquidation**  The applicant for leave must first show that the case they wish to bring has some merit so as not to risk dissipating the company's assets on hopeless litigation. It is necessary to ensure that the claim has a solid foundation and gives rise to a serious dispute. Applying this test, Le Miere J was satisfied that the claim which the plaintiffs sought to bring had a solid foundation and gave rise to a serious dispute. Le Miere J concluded that the amounts and seriousness of the plaintiffs' claims and the degree of complexity of the legal and factual issues involved made it appropriate for their claims to proceed by action rather than proof of debt.  The liquidators submitted that the plaintiffs' application for leave to commence proceedings against GSMAL for damages and compensation should be refused on the ground that the application was premature as the plaintiffs had not, or not sufficiently, identified the losses they claimed to have suffered. Observing that the assessment and quantification of any loss and damage suffered by the plaintiffs is a complex issue, Le Miere J concluded that the plaintiffs had sufficiently identified their alleged loss and damage to justify leave being granted to commence proceedings against the company.  In considering whether to grant leave Le Miere J noted that the court should have regard to whether the action will affect the orderly winding up of the company and whether any action would prejudice the other creditors. Le Miere J granted leave to commence proceedings against GSMAL for damages and compensation for three principal reasons, namely:   * the plaintiffs' claim was factually and legally complex and litigation would be a more convenient way to resolve the claims than the proof of debt procedure; * the plaintiffs proposed to bring actions against the directors of GSMAL which were inextricably linked to the proposed claim against GSMAL and the court should avoid a multiplicity of proceedings wherever possible; and * there was a likelihood that the company was insured against the plaintiffs' claim because it was a condition of GSMAL's Australian Financial Services licence that GSMAL must maintain an insurance policy covering professional indemnity and fraud by officers and a facsimile from the solicitors for the administrators of GSMAL stated that their clients would provide a copy of the draft writ and statement of claim to GSMAL's insurers.   **(iii) Leave to commence proceedings to inspect books**  Le Miere J noted that there was good reason to give the plaintiffs leave to commence proceedings against the company for an order under section 247A so that they may ascertain the existence and extent of any relevant insurance cover held by the GSMAL. If GSMAL did not have insurance cover against the plaintiffs' claims or the limit of the cover made the plaintiffs proposed action commercially not viable, then it would be expected that the plaintiffs would not proceed with the action.  The liquidators argued that leave should be refused for the following reasons:   * the plaintiffs did not have standing to bring the application as they were no longer members of the scheme; * the insurance policies providing indemnity to the responsible entity or its officers were not books of the scheme managed by the responsible entity; * the use of section 247A to access such insurance policies is not a 'proper purpose' within the meaning of section 247A; and * it is not appropriate in the circumstances that the court exercise its discretion in favour of the plaintiffs.   Le Miere J granted leave to commence proceedings for the inspection of the books of the defendant with some conditions, having respectively concluded that:   * the scheme had not been formally wound up and the plaintiffs remain members of the scheme; * 'books of the Scheme' should be given a broad construction so as to facilitate the inspection of documents relevant to the affairs and interests of the Scheme and accordingly insurance policies which may respond to the plaintiffs' claims are for the benefit of the members as well as the responsible entity and are books of the Scheme; * the purpose of the plaintiffs in seeking access to the relevant insurance policies was to assist them in considering the economic viability of pursuing their proposed action against the company, which is a proper purpose; and * it is an appropriate exercise of the discretion of the court to make an order granting access to the company's relevant insurance policies, which may prevent the resources of the parties and public resources being wasted.   [etailed Contents](http://www.law.unimelb.edu.au/bulletins/152%20April%202010.htm%23h5)  **5.7 The court's role in granting orders to convene shareholders' meetings for a proposed scheme of arrangement**  (By Amruta Bapat, Blake Dawson)  Seven Network Limited (ACN 052 816 789), in the matter of Seven Network Limited [2010] FCA 220, Federal Court of Australia, Jacobson J, 16 March 2010  The full text of this judgment is available at:  [http://cclsr.law.unimelb.edu.au/judgments/states/federal/2010/march/2010fca220.htm](http://cclsr.law.unimelb.edu.au/judgments/states/federal/2010/march/2010fca220.htm" \t "_new)  or  [http://cclsr.law.unimelb.edu.au/judgments/search/advcorp.asp](http://cclsr.law.unimelb.edu.au/judgments/search/advcorp.asp" \t "_new)  **(a) Summary**  The applicant, Seven Network Limited (Seven) sought orders under section 411 of the [Corporations Act](http://my.lawlex.com.au/default.asp?cid=56482&itid=0&ntid=0&nid=&alpha=&alphaid=&jurid=&ihl=&nhl=&fp=&top=exp&nav=col&pact=coredoc" \t "_default) allowing the convening of shareholders' meetings in relation to two proposed schemes of arrangement. This case considered the court's role in granting such orders and whether the assistance of amicus curiae should be sought when deciding to grant such orders.  Under section 411 of the Corporations Act, a company may apply to the Court for leave to convene a meeting of shareholders to vote on a proposed scheme of arrangement.  The orders sought by Seven were ultimately granted by Jacobson J without the assistance of amicus curiae. In reaching this decision, Jacobson J was influenced by the following factors:   * an order granting leave to convene shareholders' meetings is a preliminary step in the procedure required to implement schemes of arrangement, and the court retains discretion to reject the schemes at a later stage; * the Australian Securities and Investments Commission (ASIC) had thoroughly considered the schemes in question and did not propose to oppose them; * all necessary disclosures in relation to the proposed schemes had been made to the affected shareholders; and * commercial matters are ultimately to be judged by shareholders and not by the court.   **(b) Facts**  Seven proposed two schemes of arrangement, referred to by the court as the Seven Scheme and the TELYS3 Scheme respectively.  **(i) The Seven Scheme**  On 22 February 2010, Seven announced a proposed merger by way of scheme of arrangement between Seven and WesTrac Holdings Pty Limited (WesTrac) to form a new entity, Seven Group Holdings Ltd (SGH). WesTrac is owned by Australian Capital Equity Pty Limited (ACE), which is ultimately controlled by Mr Kerry Stokes AC.  The terms of the Seven Scheme were such that Seven shareholders would receive one SGH share for every Seven share held. ACE would receive 115 million SGH shares in consideration for the transfer of WesTrac to the merged entity. If implemented, the Seven Scheme will result in a dilution to the holding of Seven shareholders in SGH, as these shareholders currently have a 51.3% majority shareholding in Seven. It will also result in a 67.9% majority in SGH being held by entities associated with Mr Stokes. Approval of the Seven Scheme will result in the official quotation of Seven shares being terminated by the Australian Securities Exchange (ASX) and SGH becoming the listed entity.  The Seven Scheme was recommended by Seven's independent directors and found to be fair and reasonable by an independent expert, Deloitte Corporate Finance Pty Limited (Deloitte).  **(ii) The TELYS3 Scheme**  Seven also proposed a second scheme relating to the holders of security interests known as Transferable Extendable Listed Yield Shares (TELYS3), issued by Seven. Under the TELYS3 Scheme, holders of TELYS3 securities are to be given the opportunity to exchange these securities for similar securities issued by SGH and known as TELYS4. The TELYS3 Scheme is conditional upon the Seven Scheme being approved.  Pursuant to the TELYS3 Scheme, holders of TELYS3 securities will be made a 'TELYS4 offer'. This offer is conditional upon the Seven Scheme being approved but the TELYS3 Scheme being unsuccessful. The TELYS4 offer will provide TELYS3 holders the opportunity to exchange every TELYS3 security held for one TELYS4 security. The TELYS3 Scheme was also found to be fair and reasonable by Deloitte.  **(iii) Unusual aspects of this transaction**  Jacobson J noted that an application for leave to convene meetings is usually conducted ex parte without a contradictor. However, his Honour noted that the schemes proposed by Seven were different from those usually considered by the court, for the following reasons:   * the proposed acquirer, ACE, already holds approximately 48% of the shares in Seven; * there are no apparent business synergies between Seven, a leading media company and WesTrac, which supplies earthmoving equipment; and * if the merger is successful, the merged entity SGH will have borrowings highly in excess of those currently held by Seven.   In light of these facts, Jacobson J considered whether the assistance of amicus curiae should be sought in deciding whether to grant the orders requested by Seven.  **(c) Decision**  Jacobson J granted leave to convene shareholders' meetings without the assistance of amicus curiae. In reaching this decision, his Honour summarised the key principles relating to the court's role in granting leave to convene scheme meetings as follows:   * the commercial judgment of properly informed shareholders is to be given primacy over that of the court; * the ex parte nature of the proceedings imposes a heavy burden on the applicant to alert the court to all matters which may be relevant to the exercise of the court's discretion; * as a general rule, leave to convene a meeting should ordinarily be granted if the proposed scheme: * is fit for consideration by shareholders; * is likely to be allowed by the court following shareholder approval; and * before granting leave, the court should be satisfied that ASIC has had a reasonable opportunity to examine the proposed scheme.   Jacobson J noted that the granting of leave to convene shareholders' meetings does not oblige the court to approve the schemes at the second hearing. Rather, the court retains discretion to reject the schemes at a later stage. This was a relevant factor in his Honour's decision to grant the orders requested.  The fact that the schemes in question had been reviewed extensively by ASIC was held by Jacobson J to be significant. His Honour underscored the importance of ASIC's role in reviewing proposed schemes, particularly at the second court hearing.  Jacobson J noted that transactions such as those proposed by Seven are critical to allowing markets to operate in a fair manner. His Honour emphasised the importance of ensuring that shareholders are fully informed of the terms of such transactions. It was accepted that in this case, all necessary disclosures had been made by Seven to the affected shareholders.  Finally, Jacobson J affirmed the principle that shareholders should be permitted to exercise their judgment in relation to commercial matters, and that the court's judgment is not to be substituted for that of properly informed shareholders.  [etailed Contents](http://www.law.unimelb.edu.au/bulletins/152%20April%202010.htm%23h5)  **5.8 The application of section 253E to custodians and the construction of 'business relationship' in section 16(1)(a) of the Corporations Act**  (By William Newland, Freehills)  Everest Capital Limited v Trust Company Limited [2010] NSWSC 231, Supreme Court of New South Wales, White J, 12 March 2010  The full text of this judgment is available at:  [http://cclsr.law.unimelb.edu.au/judgments/states/nsw/2010/march/2010nswsc231.htm](http://cclsr.law.unimelb.edu.au/judgments/states/nsw/2010/march/2010nswsc231.htm" \t "_new)  or  [http://cclsr.law.unimelb.edu.au/judgments/search/advcorp.asp](http://cclsr.law.unimelb.edu.au/judgments/search/advcorp.asp" \t "_new)  **(a) Summary**  The case stands for the proposition that where:   * a unit holder holds units in a unit trust; and * the unit holder holds those units as a custodian for the trustee (ie, where the trustee is also, indirectly, a unit holder); and * a vote is to be cast on a matter in which the trustee has an interest other than as a member of the fund; then   section 253E of the Corporations Act precludes the custodian from voting.  According to this case, section 16(1)(a) of the Corporations Act, which excludes certain 'business relationships' from being classified as 'associates' does not apply to parties linked by an ongoing, rather than a once-off, relationship, for example, a custody agreement will not be considered a 'mere' business relationship. On this point, White J disagreed with Hayne J of the Victorian Supreme Court, who had construed 'business relationship' more broadly in an earlier case.  **(b) Facts**  The trustee of the Trust at the centre of this case was Everest Capital Limited (ECL). The Trust had only two unit holders on its register. One was ANZ Nominees Limited (ANZ Nominees), who held approximately 27 percent of the issued units. ANZ Nominees held the units under a sub-custody agreement with ANZ Banking Group Limited (ANZ Banking Group), who in turn held the units under a custody agreement with ECL. ECL held the units as the trustee of an investment trust called the EAIT Direct Investment Fund (EDIF). Thus, ECL was both the trustee of the Trust and, indirectly, a beneficiary as well. The other unit holder was Trust Company Limited, who held 73 percent of the issued units as custodian for Permanent Investment Management Limited (PIML).  Section 253E of the [Corporations Act](http://my.lawlex.com.au/default.asp?cid=56482&itid=0&ntid=0&nid=&alpha=&alphaid=&jurid=&ihl=&nhl=&fp=&top=exp&nav=col&pact=coredoc" \t "_default) states that: 'The responsible entity of a registered scheme and its associates are not entitled to vote their interest on a resolution at a meeting of the scheme's members if they have an interest in the resolution or matter other than as a member.' This provision, by its terms, usually only applies to responsible entities of registered schemes. Although the Trust in this case was not a registered scheme, a clause in the trust deed made certain Corporations Act provisions apply as if it was a registered scheme; section 253E was one such provision.  The trust deed provided that the trustee must retire if directed to do so by a unanimous resolution passed by unit holders. PIML wanted to have such a resolution passed. It wanted ECL removed as trustee and replaced with PIML. White J held that ANZ Nominees could not vote its interest on that resolution.  **(c) Decision**  There are two conceptually distinct reasons for the decision. First, where the trustee has the authority to control or direct the vote cast by the custodian, the court will view the vote as in substance being cast by the trustee, and therefore caught by section 253E. White J said, 'The fact the voting rights attach to units which are held by ANZ Nominees does not alter the fact that it is ECL who is entitled to the benefit of the units as responsible entity of EDIF, and to the rights attaching to them including the right to vote.'  The second reason is more complicated. If the relationship between the custodian and the trustee is such that they are "associates", as defined in the Corporations Act, the vote will be caught by section 253E. PIML relied on the definitions of associate in section 12(2)(c), or section 15(1)(a) or (c).  Section 12(2)(c) provides that 'a person (the second person) is an associate of the primary person if … the second person is a person with whom the primary person is acting, or proposing to act, in concert in relation to the designated body's affairs.'  Section 15(1)(a) and (c) provide that a reference to an associate in the Corporations Act will include 'a person in concert with whom the primary person is acting, or proposes to act; and . a person with whom the primary person is, or proposes to become, associated, whether formally or informally, in any other way; in respect of the matter to which the associate reference relates.'  White J held that 'Although the object or purpose of ANZ Nominees, if it votes its units, would presumably be to act on the directions of ECL conveyed to it through ANZ Banking Group, that object or purpose is sufficiently common to ECL's object or purpose that the giving of the direction would result in them acting in concert'. Authority for this proposition was *Heine Management Ltd v ASIC* (1993) 12 ACSR 578.  ECL sought to evade being recognised as an associate by virtue of section 16(1)(a) of the Corporations Act, which provides that 'A person is not an associate of another person by virtue of section 12 or subsection 15(1) … merely because of one or more of the following: (a) one gives advice to the other, or acts on the other's behalf, in the proper performance of the functions attaching to a professional capacity or a business relationship'. The submission was, as summarised by White J, that 'in voting in accordance with ECL's directions, ANZ Nominees would be, and would merely be, acting on ECL's behalf in the proper performance of functions attaching to the business relationship.' This would mean that, even if the definition of associate in sections 12 or 15 caught ANZ Nominees, the exclusion in section 16(1)(a) meant that the two entities were not associates.  Authority for this submission was found in the Heine case. There, Hayne J (then a judge of the Victorian Supreme Court) held that when a custodian or nominee company casts a vote at the direction of the other party, it does so because of the 'business relationship' that exists between them. This business relationship falls under the provisions of section 16(1)(a) of the Corporations Act, and therefore the parties are excluded from being associates.  White J disagreed with this construction of section 16. His Honour placed great emphasis on the words 'merely because' in section 16, and held that, were ANZ Nominees to cast its vote on the proposed resolution, it would not be acting in concert with ECL 'merely because' of a relationship that came about for the purposes of this particular vote, but also because there was 'an anterior relationship' embodied in the sub-custody agreement. According to this construction of section 16, where an ongoing custody agreement is in place, the nature of the relationship is beyond the 'business relationship' referred to in section 16.  The court held that ANZ Nominees is ECL's associate because it proposes to act in concert with ECL, not merely in the casting of this vote, but also in any number of situations that might arise under the sub-custody agreement. This obviously narrows greatly the scope of relationships that can obtain the protection of section 16(1)(a).  This raises a question as to the usefulness of the section 16(1)(a) exclusion. Counsel for ECL submitted that a person would nearly always propose to act in concert with the primary person before actually doing so, and therefore the section 16(1)(a) exclusion would protect virtually no-one. To this, White J held that 'The type of case to be excluded under s 16 can be gleaned from paras (b)-(d)'. These provisions apply to exclude brokers acquiring financial products for clients, parties linked only because one has sent, or intends to send, the other an offer under a takeover bid, and parties who act as proxies or representatives at meetings. In light of these types of relationship, White J viewed the relationship between ANZ Nominees and ECL as not falling within the exclusion in section 16(1)(a).  Given that White J held that ANZ Nominees would not be able to vote even if it was not an associate of ECL (since the trustee has the authority to control or direct the vote cast by the custodian), the decision on the applicability of the section 16(1)(a) exclusion would not have affected the outcome of the case. ANZ Nominees would be unable to vote whether it was an associate or not. However, given the divergence in views on this point between the Supreme Court of Victoria in the Heine case and the Supreme Court of New South Wales in this case, these competing constructions of section 16(1)(a) are noteworthy.  [etailed Contents](http://www.law.unimelb.edu.au/bulletins/152%20April%202010.htm%23h5)  **5.9 Court order under section 447A of the Corporations Act can be made with reference to a Part of the Act and/or Regulations in the Act**  (By Lauren Huberman, Blake Dawson)  Re Octaviar Ltd (No 8) [2010] QCA 45, Supreme Court of Queensland, Court of Appeal, Keane JA, Muir JA and Chesterman JA, 9 March 2010  The full text of this judgment is available at:  [http://cclsr.law.unimelb.edu.au/judgments/states/qld/2010/february/2010qca45.htm](http://cclsr.law.unimelb.edu.au/judgments/states/qld/2010/february/2010qca45.htm" \t "_new)  or  [http://cclsr.law.unimelb.edu.au/judgments/search/advcorp.asp](http://cclsr.law.unimelb.edu.au/judgments/search/advcorp.asp" \t "_new)  **(a) Summary**  The case considered the legislative meaning of "this Part" in section 447A of the Act. It was argued that the decision at first instance was incorrect because section 447A of the Act only refers to "this Part" of the Act (being Part 5.3A) and not the Regulations (being Regulations 5.3A). Their Honours agreed with the ruling at first instance and upheld that "this Part" of the Act is taken to include reference to Regulations which apply that specific Part of the Act.  **(b) Facts**  On 4 June 2008 the Public Trustee of Queensland applied for the winding up of Octaviar Limited (Octaviar). On 9 September 2009 it was ordered that liquidators be appointed to the company to wind it up in insolvency. Octaviar entered into a Deed of Company Arrangement between the application for winding up and the order for winding up. On 31 July 2009 the primary judge ordered that the Deed of Company Arrangement be terminated and that Part 5.3A of the Act apply to Octaviar. In addition, the order excluded the application of section 446B and regulation 5.3A.07 of the Act. The effect of this was to enable a court-ordered winding up rather than a creditors' voluntary winding up. The court-ordered winding up gives wider protection to Octaviar's creditors. If the winding up occurred by a creditors' voluntary winding up then certain dealings between Octaviar and Fortress Credit Corporation (Australia) II Pty Limited (Fortress) (the appellant) would have been outside the scope of any proceedings.  The primary judge made the order pursuant to section 447A Act. Section 447A(1) of the Act states that "the Court may make such order as it thinks appropriate about how this Part is to operate in relation to a particular company." Section 447A appears in Part 5.3A of the Act.  Fortress appealed on the basis that the court was incorrect in excluding the operation of Regulation 5.3A.07 because a reference to "this Part" of the Act does not include reference to the Corporations Act Regulations.  **(c) Decision**  Keane JA held that the primary judge was authorised by section 447A of the Act to make the order.  Keane JA noted the High Court's decision in *Australasian Memory Pty Limited v Brien* (2000) 200 CLR 270. In that case the High Court held that powers conferred on the court by section 447A of the Act are wide and there is no reason to read them down.  In addition Keane JA discussed the operation of Regulation 5.3A.07 of the Act. His honour stated that this regulation operates "for the purpose" of section 446B of the Act. Therefore, section 446B and Regulation 5.3A.07 of the Act should be read together. Accordingly, it is accurate to characterise "this Part" in section 447A of the Act to include the Regulations which belong to Part 5.3A of the Act.  The appeal was dismissed. Muir and Chesterman JJA agreed with Keane JA's reasoning.  [etailed Contents](http://www.law.unimelb.edu.au/bulletins/152%20April%202010.htm%23h5)  **5.10 Oppression and winding-up: when is a broken relationship not enough?**  (By Stefania Gardner, Freehills)  Tomanovic v Argyle HQ Pty Ltd; Tomanovic v Global Mortgage Equity Corporations Pty Ltd; Sayer v Tomanovic [2010] NSWSC 152, New South Wales Supreme Court, Austin J, 5 March 2010  The full text of this judgment is available at:  [http://cclsr.law.unimelb.edu.au/judgments/states/nsw/2010/march/2010nswsc152.htm](http://cclsr.law.unimelb.edu.au/judgments/states/nsw/2010/march/2010nswsc152.htm" \t "_new)  or  [http://cclsr.law.unimelb.edu.au/judgments/search/advcorp.asp](http://cclsr.law.unimelb.edu.au/judgments/search/advcorp.asp" \t "_new)  All legislation references in this case note are to the [Corporations Act 2001 (Cth)](http://my.lawlex.com.au/default.asp?cid=56482&itid=0&ntid=0&nid=&alpha=&alphaid=&jurid=&ihl=&nhl=&fp=&top=exp&nav=col&pact=coredoc" \t "_default).  **(a) Summary**  Tomanovic and Sayer were in a "loose" partnership from about 1999 to December 2004, when they began negotiating to dissolve the partnership on friendly terms. The relationship became sour when the separation of their business interests could not be finalised. As a result, the following actions were brought:   * an action by Tomanovic and Australian Financial Services Corporation Pty Ltd ("AFSC") (together "the Tomanovic Interests") which sought the winding up of one of the partnership companies, Global Mortgage Equity Corporation Pty Ltd ("GMEC"), on either the oppression ground (section 461(1)(f)) or the just and equitable ground (section 461(1)(k)) or, alternatively, the making of a buy-out order under Part 2F.1; * an action by the Tomanovic Interests, for the same relief, in relation to another partnership company, Argyle HQ Pty Ltd ("Argyle HQ'); and * an action by Sayer, Ken Sayer Investments Limited Pty Ltd ("KSIPL") and Mortgage House of Australia Pty Ltd ("MHA") (together "the Sayer Interests") which sought the recovery from the Tomanovic Interests of $1,341,750.   Justice Austin found that there were insufficient grounds to grant the relief sought by the Tomanovic Interests as:   * the separation agreements relied upon by Tomanovic were not binding; * the conduct of the Sayer Interests was consistent with the parties expectations and was therefore not oppressive; and * a winding up order should not generally be made of a commercially viable business.   Consequentially, Austin J upheld the action brought by the Sayer Interests.  **(b) Facts**  From 2003, the partnership involved two groups: the Finance Group (a large multi-service mortgage business) and the Non-Finance Group (providing specialised mortgage strategies, loans and investments).  **(i) The Finance Group**  The Holding company of the Finance Group was GMEC which was 45% owned by AFSC (100% owned by the Tomanovic Interests) and 55% owned by One Australia Pty Ltd ("One Australia") (100% owned by the Sayer Interests).  It was agreed by the parties that Sayer would be the "top boss and ultimate decision maker in control of the money side of the business". Since June 2003, Sayer had been the sole director of GMEC and since 2004, Tomanovic had not played an active part in the Finance Group business.  **(ii) The Non-Finance Group**  AFSC and One Australia both had interests in a number of subsidiaries in the Non-Finance Group, including Multi-own (run primarily by Tomanovic) and 9 Argyle St Unit Trust. Argyle HQ was trustee of 9 Argyle St Unit Trust and was equally owned by the Sayer Interests and the Tomanovic Interests.  **(iii) The separation of the partnership**  From about mid-2004, negotiations commenced for the Sayer Interests to buy out the Tomanovic Interests in the Finance Group companies. A number of "Agreements" were drawn up by the parties to facilitate the separation. Relations between the parties became strained when the final separation did not proceed and as a consequence the Tomanovic Interests brought the proceedings.  **(c) Decision**  **(i) Were any of the Agreements legally binding?**  Justice Austin summarised the relevant legal principles for determining whether any of the Agreements were legally binding as:   * Intention to enter into legal relations - Austin J cited the case of *Masters v Cameron* (1954) 91 CLR 353 in which it was held that there will be no binding agreement where the intention of the parties is not to make a concluded bargain at all, unless and until they execute a formal contract; * Incompleteness - there can be no binding and enforceable contractual obligation unless the terms of the bargain, or at least its essential or critical terms, have been agreed upon (generally parties, property and price); and * Uncertainty - for there to be a valid and enforceable contract, the court must be able to attribute to it a sufficiently precise and clear meaning to identify the scope of the rights and obligations to which the parties had agreed.   If the court concludes that the parties intended to enter into legal relations, it will endeavour to cure any problems posed by Uncertainty and Incompleteness.  Justice Austin considered that the Agreements had the following issues:   * Kirribilli Heads of Agreement ("HoA") (December 2004) - absence of sale price, subject matter uncertain, informal document; * First HoA - provided for Sayer Interests to acquire the Tomanovic shareholding in AFSC for $6 million and for Tomanovic to retain the Multi-own companies however stated it was not intended to be binding, contemplated formal documents being prepared (never finalised), had uncertain subject matter; * Memorandum of Understanding (November 2006) - single page handwritten document, evidence showed was agreement to agree; and * Second HoA (November 2006) - varied First HoA to reduce the purchase price to $5 million and had the same issues as the First HoA.   On this basis, Austin J held that none of the Agreements were intended to be legally binding and, in any event, the incompleteness and uncertainty that existed was quite fundamental and could not have been rectified by the court.  **(ii) Part performance**  The Tomanovic Interests also argued that the Agreements were legally binding due to part performance. Conduct relied upon included that Tomanovic was paid $1,241,750 under the First HoA and $100,000 under the Second HoA. Justice Austin stated that it was possible for conduct to give rise to a contract in certain circumstances but only where it clearly demonstrated an intention to be bound.  The Sayer Interests argued that the First HoA provided that any payments made to Tomanovic were a loan which would become immediately due and payable in the event that formal documents were not executed by the parties. Justice Austin held this clause was inconsistent with Sayer's conduct giving rise to a contract.  **(iii) Estoppel**  The Tomanovic Interests also argued that the Sayer Interests were estopped from denying that the Agreements were binding due to their conduct. Justice Austin held that Sayer's conduct was entirely consistent with the parties' mutual expectation that separation of interests would proceed once formal documentation was settled and that the evidence supported a finding that Tomanovic never thought the Agreements were legally binding and therefore there was no reliance to support an estoppel.  **(iv) Did the actions of the Sayer Interests amount to oppression?**  In assessing an oppression claim under section 232, Justice Austin stated that the test is whether "objectively in the eyes of a commercial bystander, there has been unfairness, namely conduct that is so unfair that reasonable directors who consider the matter would not have thought the decision fair" or whether there is conduct inconsistent with the legitimate expectations of shareholders.  Further, if oppression is shown, a compulsory buy-out should not be ordered if less drastic remedies are available and winding up should be regarded as a last resort.  The Tomanovic Interests alleged the following categories of oppression:   * Category 1: Failure of Sayer Interests to complete the separation of interests envisaged by the First HoA (as amended by the Second HoA) and buy-out the Tomanovic interests while excluding Tomanovic from management; * Category 2: Diversion of assets of GMEC for benefit of Sayer Interests; * Category 3: Reduction in Argyle HQ assets for benefit of Sayer Interests, without consent, and unauthorised assumption of voting control of Argyle HQ; and * Category 4: Oppressive conduct generally, including failure to make books and records available and failure to reinstate Tomanovic as director.   In regard to Category 1, Justice Austin held that none of the Agreements were legally binding (as discussed above) and therefore this could not form a basis of oppression. In relation to the failure to buy-out the Tomanovic Interests, Austin J held that there was no evidence of unfairness arising out of Sayer's failure to consummate the separation of interests and that the "oppression remedy is not simply a free ticket for a forced sale of an interest".  In regard to Category 2, Tomanovic's primary allegation related to Sayer acquiring the B Class share in some GMEC subsidiaries. Justice Austin found that the issue of the B Class share simply gave Sayer the final say in a shareholders deadlock which was entirely consistent with the arrangement between the parties.  In relation to Category 3, Tomanovic's primary allegation related to the increase in the St George Bank Facility for the Finance Group. Austin J found that the extension of the facility was procured for legitimate business purposes and in the circumstances it was not improper for Sayer to proceed without the consent of Tomanovic.  In relation to Category 4, Austin J found that the general oppressive conduct complained of by Tomanovic was explainable by the ordinary conduct of the businesses and was not oppressive.  In regard to Tomanovic's expectation of being reinstated as a director, Justice Austin found that he had no such legitimate expectation given that he never played a significant role in the MHA Finance Business and even if there were a frustration of a legitimate expectation of management, it is not the mere exclusion from management but this coupled with the failure to make a reasonable offer to "buy-out" the minority interest that constitutes oppression - on these facts there were two concrete and unimpeachably reasonable offers to buy-out the Tomanovic Interests.  In conclusion, Austin J held that there was no basis for the invocation of the oppression remedy to impose a compulsory buy-out or to support a winding up.  **(v) Did the Sayer Interests' conduct support a winding-up order on the just and equitable ground?**  Austin J stated that the court does have a very wide discretion under section 461(1)(k) to wind up on the "just and equitable" ground however his Honour cited the leading case of *Ebrahimi v Westbourne Galleries Ltd* [1973] AC 360 ("Ebrahimi"), in which it was held that "equitable considerations" justifying the winding up of a company arise when one or typically more of the following characteristics are present:   * an association formed or continued on the basis of a personal relationship, involving mutual confidence; * an agreement, or understanding, that all, or some of the shareholders will participate in the conduct of the business; * the restriction upon the transfer of the member's interest in the company – so that if confidence is lost, or one member is removed from management, he cannot take out his stake and go elsewhere.   Further, Ebrahimi is not authority for the principle that any "breakdown" or "loss of confidence" provides a sufficient foundation for winding up, usually:   * the "breakdown" must materially frustrate the commercially viable and sensible operation of the company in accordance with the incorporators' expectations and any "loss of confidence" must be justified (i.e. mere disagreement is insufficient); and * there must be a restriction upon the transfer of the member's interest.   Another important factor in the exercise of the court's discretion is the extent to which the applicant is responsible for any breakdown of the relationship. On the facts, there had been a breakdown and lack of trust between the two shareholders but it had not prevented the business interests from co-operating and had no effect on the business in a managerial sense. In conclusion, Justice Austin found that:   * there was no basis for winding up on the just and equitable ground arising merely from the failure to consummate the separation of interests; * there was no basis for a finding that there was a justified lack of confidence in Sayer's management of the business; and * another factor weighing against the making of a winding up order was that the relief would likely compromise the business as a going concern and cause a very substantial loss of shareholder value.   **(vi) Did the Sayer Interests succeed in their claim against Tomanovic?**  On the basis of the above, Justice Austin concluded that the amount of $1,341,750 paid to Tomanovic under the HoAs was a loan and was due and payable to the Sayer Interests under the terms of the HoAs as no formal separation documentation had been finalised.  [etailed Contents](http://www.law.unimelb.edu.au/bulletins/152%20April%202010.htm%23h5)  **5.11 Requirements for necessary intention to create a Quistclose trust**  (By Katrina Sleiman, Corrs Chambers Westgarth)  Compass Resources Ltd v Sherman [2010] WASC 41, Supreme Court of Western Australia, Beech J, 5 March 2010  The full text of this judgment is available at:  [http://cclsr.law.unimelb.edu.au/judgments/states/wa/2010/march/2010wasc41.htm](http://cclsr.law.unimelb.edu.au/judgments/states/wa/2010/march/2010wasc41.htm" \t "_new)  or  [http://cclsr.law.unimelb.edu.au/judgments/search/advcorp.asp](http://cclsr.law.unimelb.edu.au/judgments/search/advcorp.asp" \t "_new)  **(a) Summary**  The case involved an application by the plaintiff, Compass Resources Ltd (Compass) for a declaration in relation to funds it held in a bank account. Those funds were paid to it by the second defendant, Hunan Nonferrous Metals Corporation Ltd (HNC) pursuant to a convertible note facility agreement (the Facility Agreement) made between Compass and HNC. By clause 6 of the Facility Agreement, Compass agreed to use at least 70% of the loan funds for specified purposes. The issue was whether terms of the Facility Agreement, in particular clause 6, meant that the funds were received by Compass as trustee of a Quistclose trust.  The court was not satisfied that HNC and Compass had the intention that the loan funds be held by Compass only to be used for the purposes stated in clause 6. Rather, the court considered that the parties intended that the loan funds become Compass' property. The court came to that conclusion taking into account the context and surrounding circumstances, the evident commercial purpose of the transaction, the absence of any stipulation that the funds be paid into a particular account and be kept separate from other funds of Compass, and other provisions of the Facility Agreement.  **(b) Facts**  Most of Compass' business is conducted pursuant to three joint ventures with the third defendant (HAR), which is a wholly owned subsidiary of HNC, a Chinese company. The first defendant, Compass Mining Pty Ltd (CMPL) is a wholly owned subsidiary of Compass. Until about 30 April 2009, CMPL was the operator of two of the joint ventures between Compass and HAR.  On 19 November 2008, Compass and HNC entered into the Facility Agreement. The substance of the Facility Agreement was that, subject to conditions, HNC would lend US$10 million to Compass and Compass would issue convertible notes entitling HNC to convert the debt to shares in Compass. Clause 6 of the Facility Agreement is headed 'Use of the Loan', and is in the following terms: "[Compass] agrees and acknowledges that at least 70% of the amount to be advanced under this agreement must be used to meet [Compass'] obligations under the Oxide Joint Venture and to pay rent and employees of [Compass] in ordinary course of business."  On 29 January 2009, Compass and CMPL each appointed voluntary administrators (the Administrators) under section 436A of the Corporations Act 2001 (Cth). On 17 February 2009, HAR, as chargee under various charges, appointed joint and several receivers (Receivers) to all the assets of Compass and CMPL. On 30 April 2009, the creditors of Compass approved Compass entering into a deed of company arrangement. A deed of company arrangement was executed on 21 May 2009 by the Administrators and by Compass.  On 21 May 2009, the Receivers of Compass resigned from their appointment as Receivers under one of the charges. As a result, they were no longer appointed as Receivers of funds held in several bank accounts that Compass held with Bankwest, which included the funds relevant to the proceedings.  On 30 April 2009, the creditors of CMPL resolved that CMPL should be wound up. The Administrators became the liquidators of CMPL.  HNC lodged an informal proof of debt in the administration of Compass. The proof of debt claimed the sum of US$10 million under the Facility Agreement. The proof of debt stated that the effect of clause 6 of the Facility Agreement was that US$7 million of the loan amount was subject to a Quistclose trust, pursuant to the principles in *Barclays Bank Ltd v Quistclose Investments Ltd* [1970] 1 AC 567, and must be applied in accordance with the terms of that trust and so is not available to meet the claims of ordinary unsecured creditors.  **(c) Decision**  The court considered that generally, in commercial transactions, when A advances money to B, the relationship between A and B is debtor and creditor. However, the circumstances may give rise to obligations of trust or of a fiduciary character. The court accepted that what is necessary is an intention that the funds not become the property of the borrower and the borrower be permitted to use the funds only for the specified purpose.  The court referred to the ratio of Barclays Bank v Quistclose Investments as being that where money is advanced by A to B, with the mutual intention that it should not become part of the assets of B, but should be used exclusively for a specific purpose, there will be implied (at least in the absence of an indication of a contrary intention) a stipulation that if the purpose fails the money will be repaid, and the arrangement will give rise to a relationship of a fiduciary character, or trust.  The court considered that the test of the necessary intention is whether it is intended that the monies not become part of the general assets of the company and be used only for the particular purpose. It is not sufficient, in order to establish a trust, to show that the parties intended that the monies be used only for a particular purpose, as not every contractual obligation to use loan funds for a specified purpose gives rise to a trust of the monies lent. In determining the question of intention the court will have regard to the language employed by the parties, including in the particular clause in question, the nature of the transaction, and the circumstances surrounding the relationship. Whether there is expressed a requirement that the funds be kept separate from other monies of the borrower is a significant consideration in determining the question of intention.  In determining whether HNC and Compass had the intention that the loan funds not become part of the assets of Compass but be held by Compass only to be used for the purposes stated in clause 6, the court considered a number of issues.  First, the Facility Agreement did not contain any provision requiring the loan funds to be placed into a new or separate account, or prohibiting the mixing of the loan funds with other funds of Compass. The effect of clause 2.1 of the Facility Agreement was to permit Compass to determine the bank account into which the loan funds were to be paid. There was nothing in the express terms of the Facility Agreement, or arising by necessary implication, to preclude Compass from specifying its general bank account for the receipt of the loan funds and then mixing the loan funds with other funds of Compass. The court considered this a factor of considerable significance and a strong indication of an intention that the loan funds become the property of Compass.  Second, the court considered that the purposes of clause 6 may be viewed as akin to use of the funds for working capital. Compass was in a joint venture with HNC's subsidiary, HAR. HAR's joint venture obligations were guaranteed by HNC. In circumstances where Compass had liquidity problems or was in financial difficulty, the lender HNC had an interest in the continued viability of Compass. However, the protection of that interest does not require the imposition of a trust over the loan funds. The court considered that HNC's rights under the Facility Agreement, including its right to demand repayment in certain events, its right to shares in lieu of the debt in certain events, and its right to enforce clause 6, sufficiently advance HNC's evident commercial purpose.  Third, the court was not persuaded that the Facility Agreement, construed in its context, revealed an intention that the loan funds not become the property of Compass but be held on trust for the classes of persons referred to in clause 6.  The court considered that those parties were referred to in clause 6 in only a quite general way and all of them are unrelated to the lender HNC and some are also unrelated to Compass.  Fourth, the various events in which the loan would become repayable also militated strongly against finding an intention that the loan funds be held for the benefit of, in the sense of as beneficial property of, the clause 6 parties. The court considered that it would not make commercial sense for HNC to intend the loan funds to be held on trust for the clause 6 parties even in circumstances that the loan was repayable.  For these reasons, the court was not satisfied that HNC and Compass had the intention that the loan funds be held by Compass only to be used for the purposes stated in clause 6. Instead, the court considered that the parties intended that the loan funds become Compass' property.  [etailed Contents](http://www.law.unimelb.edu.au/bulletins/152%20April%202010.htm%23h5)  **5.12 Directors' duties: Determining whether a director's actions are "reasonable"**  (By Samantha Horsfield, Clayton Utz)  Ralph v Diakyne Pty Limited [2010] FCA 18, Federal Court of Australia (Full Court), Finn, Sundberg and Jacobson JJ, 4 March 2010  The full text of this judgment is available at:  [http://cclsr.law.unimelb.edu.au/judgments/states/federal/2010/march/2010fcafc18.htm](http://cclsr.law.unimelb.edu.au/judgments/states/federal/2010/march/2010fcafc18.htm" \t "_new)  or  [http://cclsr.law.unimelb.edu.au/judgments/search/advcorp.asp](http://cclsr.law.unimelb.edu.au/judgments/search/advcorp.asp" \t "_new)  **(a) Summary**  This was an appeal against a decision that a director had breached his duties to his company. The appeal addressed two of the issues dealt with by the first instance judge. The first issue was whether a director had breached his duties under sections 180, 181 and 182 of the [Corporations Act](http://my.lawlex.com.au/default.asp?cid=56482&itid=0&ntid=0&nid=&alpha=&alphaid=&jurid=&ihl=&nhl=&fp=&top=exp&nav=col&pact=coredoc" \t "_default) by authorising a bonus payment under a service contract to be made to a company in which he had a material personal interest.  The Full Federal Court upheld the first instance judge's decision, and found that there had been a clear breach of sections 180, 181 and 182 of the Corporations Act. It followed the principle in *Re HIH Insurance Limited (in prov liq) v Adler* (2002) 41 ACSR 72 (HIH), which applied an objective standard to determine whether a director was justified in adopting a particular course of action.  The second issue was the proper construction of the bonus provision of the service contract. This issue arose on the appeal because it would go to the question of quantum in the event that the Full Court affirmed the first instance judge's findings that the director breached his duties as a director. Specifically, it determined whether the loss incurred as a result of the director's actions amounted to $110,000, or whether the only loss suffered by the company was the loss of an opportunity to negotiate payment of a lesser sum.  The Full Court held that proper construction of the contract led to the conclusion that the pre-conditions for the entitlement to the bonus had not been satisfied.  **(b) Facts**  Mr Ralph was a director of Diakyne Pty Limited (Diakyne). He was also the sole director and held 99% of the issued capital in Colorado Investments Pty Limited (Colorado).  In 2007 Diakyne had become a wholly owned subsidiary of MediVac Limited (MediVac). Diakyne shareholders had agreed to sell all their shares in consideration for 66% of shares in MediVac. As a result of the transaction Mr Ralph became a director of MediVac.  On 30 November 2007 Mr Ralph resigned from the MediVac board when it became apparent that he would not be re-elected. That same afternoon, Mr Ralph authorised Diakyne to make a bonus payment of $110,000 to Colorado.  Mr Ralph contended that the bonus payment was due to Colorado under a service contract. The service contract provided Mr Ralph with an annual management fee of $240,000 for the services he provided to Diakyne, as well as a bonus payment if certain conditions were satisfied.  The bonus payment clause was essentially made up of two limbs:   * The first limb contained the conditions precedent to be met before determining whether certain percentage requirements were satisfied (Conditions Precedent).The Conditions Precedent included either the listing of Diakyne shares on a national stock exchange via an IPO or a reverse take-over, or a trade sale of the Diakyne business (or its assets). * The second limb set out the percentage requirements to be satisfied in order to trigger the bonus. It provided that the bonus was to be measured by the extent to which the "consideration" in cash or scrip exceeded the value of shareholder capital in Diakyne.   Mr Ralph argued that the completion of the reverse takeover between Diakyne and MediVac satisfied the requirements for the bonus payment.  **(c) Decision**  The first instance judge held that Mr Ralph had contravened sections 180(1), 181(1) and 182(1) of the Corporations Act in exercising his power as director of Diakyne to authorise the payment of $110,000 to Colorado. The first instance judge also held that Colorado was required to repay Diakyne $110,000 plus interests and costs. The Full Court dismissed Mr Ralph's appeal against this decision, although it is difficult to identify precisely what the grounds of appeal were.  **(i) Authorisation of bonus payment**  The Full Court upheld the first instance judge's decision and found that Mr Ralph had breached his duties as director in authorising the bonus payment to Colorado.  The Full Court appeared to agree with four critical holdings by the first instance judge:   * First, the bonus provision on which Mr Ralph relied was ambiguous, and any person acting in Diakyne's interests would have recognised these ambiguities. Mr Ralph himself acknowledged that the clause "could have been better worded", showing that the clause was not sufficiently certain to give rise to the claimed entitlement. * Second, on the day that Mr Ralph authorised the payment, he knew that it was likely that he would be removed as a director of Diakyne in the immediate future. * Third, Mr Ralph was also aware that the directors of MediVac would take steps to dispute Colorado's invoice when it was presented to them, as they were concerned about the validity and enforceability of the remuneration payable to Colorado. Therefore Mr Ralph's "actuating motive" in making the payment was to ensure that Colorado was paid in full without any opportunity for dispute by Diakyne. * Fourth, Mr Ralph intended to benefit Colorado by the making of the immediate payment, and to cause harm to Diakyne.   The Full Court held that there could be no doubt that these findings were sufficient to satisfy the tests for contravention of sections 180(1), 181(1) and 182(1) stated in the HIH case.  The Full Court rejected Mr Ralph's defence in which he argued that a director who honestly believes that the company owes a debt to a third party cannot be in breach of his or her duties to the company by causing immediate payment to be made. The Full Court observed that this argument failed to take into account all of the circumstances of the case, and these would have played a role in Mr Ralph's decision making process.  **(ii) Proper construction of service contract**  The Full Court departed from the first instance judge's reasoning on the proper construction of the service contract and found that the requirements under the first limb had not been satisfied. Nevertheless it arrived at the same conclusion as to Colorado's entitlements under the service contract, and found that a proper construction of the bonus payment clause in the service contract led to the conclusion that the requirements were not satisfied.  The following reasoning was provided:   * The Conditions Precedent had not been satisfied. The first instance judge held that a trade sale had taken place, but the Full Court disagreed. It concluded that even though Diakyne had become a wholly owned subsidiary of MediVac, Diakyne's business and assets were still owned by Diakyne, not MediVac. * The Full Court agreed with the first instance judge that the percentage requirements had not been fulfilled. Mr Ralph had determined the consideration based on the list price of the MediVac shares that were allotted to Diakyne shareholders. The Full Court held that this valuation method was untenable for several reasons:   + the list price of MediVac shares on a particular day bore no resemblance to their value;   + Mr Ralph had conceded that the shares were worth nothing like the price he had relied upon to support the bonus;   + the listed price of the MediVac shares on the day of completion of the transaction was unknown; and   + an independent written report of the value of the MediVac shares made it clear that the percentage requirements had not been met. * The Full Court noted authority for the proposition that recourse may be had to the context of a written contract, even where there is no ambiguity in the terms of such a contract. In this case, consideration of the context of the service contract included knowledge of Diakyne and Colorado that the MediVac transaction had been concluded. Once that fact was taken into account, the construction of the service contract which Mr Ralph contended was untenable.   [etailed Contents](http://www.law.unimelb.edu.au/bulletins/152%20April%202010.htm%23h5)  **5.13 Determining share value for purposes of buy out order**  (By Chris Taylor and Clare Parsons, Corrs Chambers Westgarth)  Garraway v Territory Realty Pty Ltd [2010] FCAFC 9, Federal Court of Australia, Full Court, Ryan, Rares and McKerracher JJ, 17 February 2010  The full text of this judgment is available at:  [http://cclsr.law.unimelb.edu.au/judgments/states/federal/2010/february/2010fcafc9.htm](http://cclsr.law.unimelb.edu.au/judgments/states/federal/2010/february/2010fcafc9.htm" \t "_new)  or  [http://cclsr.law.unimelb.edu.au/judgments/search/advcorp.asp](http://cclsr.law.unimelb.edu.au/judgments/search/advcorp.asp" \t "_new)  **(a) Summary**  This case involved a dispute between the majority and minority shareholders of Dundee Beach Pty Ltd, a land development company ("Company") over share price valuation for the purposes of a buy out order under section 233(1) of the [Corporations Act](http://my.lawlex.com.au/default.asp?cid=56482&itid=0&ntid=0&nid=&alpha=&alphaid=&jurid=&ihl=&nhl=&fp=&top=exp&nav=col&pact=coredoc" \t "_default).  The majority shareholders in the Company are comprised of three companies and an individual ("Appellants"). The minority shareholder is Territory Realty Pty Ltd ("Respondent"). At first instance, the trial judge found that the Appellants had used their control of the Board of the Company (on which the Respondent was not represented) to conduct the affairs of the Company in a way that was oppressive to, or unfairly discriminatory against, the Respondent.  The trial judge considered that the appropriate relief was to order a buy out by one party of the other party's interest in the Company, at a price calculated in accordance with the share value determined by the trial judge. The Appellants appealed on the grounds that the trial judge had erred in calculating the value of the shares. The Respondent cross-appealed arguing that the trial judge had undervalued the Company because of a failure to take account of unjustified management and consulting fees charged by the Appellants as a means of divesting profits from the Company.  Justices Ryan, Rares and McKerracher considered each ground of the Appellants' appeal against the trial judge's share valuation and concluded that each ground should be rejected. Their Honours considered that the trial judge's valuation was undertaken in accordance with proper principles. They held that the power of the court to make orders under section 233(1) of the Corporations Act affords the court a broad discretion and should not be construed narrowly. The fact that other remedies may have appeared to be appropriate to other persons did not suggest that the trial judge erred in the exercise of his discretion in a way that could be challenged. In considering the Respondent's cross-appeal, the court found no reason to interfere with the trial judge's exercise of his discretion to not include in his valuation a figure for the whole or a portion of the unjustified fees. Accordingly, the court dismissed the appeal and the cross-appeal.  **(b) Facts**  The trial judge held that the Appellants had conducted the affairs of the Company in a way that was oppressive to, or unfairly discriminatory against, the Respondent. In particular, the trial judge found the following conduct to be oppressive:   * a decision of the board in early 2007 to issue a further 150 shares in the Company at a price of $50,000 per share to raise $7,500,000, and an offer to buy the Respondent's one-third holding of 16 existing shares at the same price of $50,000 per share. The trial judge held that these proposals, particularly the new issue, were contrived and that no reasonable board could have considered them to be in the best interests of the Company as a whole. The proposals were designed by the Appellants to procure a buyout of the Respondent or put pressure on it to sell its shares at a grossly undervalued price; and * the "ripping off" of the Company and therefore the Respondent as shareholder by the charging of unjustifiable management and consulting fees by the Appellants over six years as a means of divesting profits from the Company.   The trial judge held that the appropriate remedy would be one which regulated the affairs of the Company in a way that avoided further oppression or unfair conduct. The trial judge concluded that the least intrusive and most appropriate relief was for one party to buy out the other, giving the Appellants the first opportunity to purchase the interest of the Respondent.  The trial judge determined the value of shares in the Company by valuing the Company's interest in real estate and arrived at a value for each share in the company of $309,312. The Appellants appealed this valuation on a number of grounds, including that:   * the global financial crisis, which occurred after judgment had been reserved, required consideration; * income tax and goods and services tax payable on the realisation of the land being valued should have been taken into account in reduction of the value of the net assets of the Company; * an expert valuation of shares in the Company was necessary before a value could be fixed for them; and * there was a less intrusive and more appropriate remedy other than a buy out by one faction of the other and the conduct of the Respondent should have affected the relief granted.   The Respondent cross-appealed on the ground that the trial judge failed to include the value of the unjustified management and consultancy fees in the valuation.  **(c) Decision**  **(i) Appeal**  The court dismissed all of the Appellants' arguments on appeal. With respect to the Appellants' grounds for appeal outlined above, the court found that:   * The trial judge had not erred in failing to have regard to the occurrence of the global financial crisis in and from September 2008. The trial judge had reserved judgment in May 2008. The Appellants did not seek to have the matter re-listed at any time between reservation of judgment and delivery of reasons. His Honour had been asked to fix a value at the particular point in time nominated by the parties in order to resolve their controversy. The risk of gain or loss after that point in time fell on whichever party retained an interest in the shares in the Company. It was not for the trial judge, nor the Appellate Court, to change the controversy between the parties or the agreed basis on which the case had been conducted at trial. * The trial judge was correct in refusing to make adjustments for goods and services tax and income tax. At trial, the impact of goods and services tax and income tax had not been addressed in the evidence and emerged only in final submissions. No deduction in value would be appropriate if no evidence had been directed to the issue at trial. In any event, any detriment suffered by a developer in paying goods and services tax in an initial acquisition could be offset on resale. * The trial judge was entitled to form a view on the value of the land and to fix a fair value for the shares, taking into account the Company's other assets and liabilities. Section 233(1) of the Corporations Act, which grants the court the power make a buy out order, does not identify the basis on which the price for shares is to be fixed. The Appellants argued that expert accounting evidence was necessary to make the valuation, however this evidence was not before the trial judge and the Appellate Court considered that the trial judge was not obliged to require an expert share valuation and it was not for the trial judge to direct either side on what evidence it should tender. * The power for the court to make orders pursuant to section 233(1) of the Corporations Act affords the court a broad discretion to "make any order…that is considers appropriate in relation to the company." This power should not be read in a way that imposes limitations on the court. The discretionary judgment exercised by the trial judge could not be set aside unless the Appellants showed that the trial judge acted upon a wrong principle, allowed extraneous or irrelevant matters to guide or affect him, mistook the facts or did not take into account some material consideration. The Appellants did not demonstrate that any of these factors existed. Contrary to the Appellants' submissions, the conduct of the Respondent did not have to affect the relief granted. The trial judge did not have to take the Respondent's conduct into account when exercising his discretion to grant relief.   **(ii) Cross-appeal**  The court held that the trial judge was not bound to include in his valuation a figure for the whole or a portion of the unjustified fees. The court noted that the trial judge had not substantially addressed how the value of the overpaid and unjustified fees should be taken into account for the purposes of the share valuation, and commented that whilst it would have been preferable for the trial judge to expressly address the treatment of the fees in relation to the valuation, it was a relatively minor issue and did not require the court's intervention.  The Respondent had also challenged the trial judge's decision to afford the majority shareholders the first right to buy out the minority. The court held that the Respondent had failed to identify any error in selecting that remedy, and as such there was no reason to interfere with the trial judge's exercise of his discretion.  [etailed Contents](http://www.law.unimelb.edu.au/bulletins/152%20April%202010.htm%23h5) | |  |  |  |  |  | | --- | --- | --- | --- | | |  |  |  | | --- | --- | --- | | **6. Contributions** |  |  | | | http://my.lawlex.com.au/alert/pic/spacer.gif | | |  | | --- | | If you would like to contribute an article or news item to the Bulletin, please email it to: "[cclsr@law.unimelb.edu.au](mailto:cclsr@law.unimelb.edu.au" \t "_new)".  [etailed Contents](http://www.law.unimelb.edu.au/bulletins/152%20April%202010.htm%23h1) | | | http://my.lawlex.com.au/alert/pic/spacer.gif |

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