



Australian Government

**Corporations and Markets
Advisory Committee**

Managed Investment Schemes

Report

July 2012

Corporations and Markets **Advisory
Committee**

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schemes**

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Australian Government

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18 July 2012

The Hon. Bernie Ripoll MP
Parliamentary Secretary to the Treasurer
Parliament House
CANBERRA ACT 2600

Dear Mr Ripoll

I am pleased to present the report by CAMAC on managed investment schemes.

The report responds to the matters raised in the terms of reference in the broader context of the overall regulation of schemes. It includes proposals for reform under the current legal framework as well as setting out an alternative legal framework for the regulation of schemes, described as the Separate Legal Entity Proposal.

Yours sincerely

A handwritten signature in black ink, appearing to read 'J Rees', written in a cursive style.

Joanne Rees
Convenor

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1 Introduction

This chapter explains the background to the review of managed investment schemes, sets out the terms of reference, provides a dictionary of key terms, describes the review process and summarises the CAMAC position and recommendations.

1.1 Background

The failure in recent years of a number of high profile managed investment schemes (schemes) has highlighted the difficulties that can arise where this form of commercial structure suffers financial stress.

Some of the problems encountered were referred to in the report by the Parliamentary Joint Committee on Corporations and Financial Services *Inquiry into aspects of agribusiness managed investment schemes* (September 2009). That report noted concerns that had been raised in consequence of the financial collapse of some large agribusiness schemes, including what was the most suitable external administration process for these schemes, whether the interests of affected parties were properly recognised in that process, how potential conflicts of duty in conducting an external administration might be dealt with, and whether fair consideration could be given in that process to continuing a scheme through restructuring its arrangements.¹

In part, these problems reflect difficulties arising from the specific arrangements entered into to operate particular agribusiness schemes. However, from a broader perspective, they also reflect developments in recent years in the use of schemes, from their original predominant role as passive investment vehicles, to their increasing use as vehicles to conduct entrepreneurial activities with enhanced investor involvement. The failure of some entrepreneurial schemes has generated legal problems that were not anticipated when the current legal framework for schemes was developed. This

¹ paras 3.99 ff.

failure, and developments in practice, point to the need for a considered review of that framework, to make it more workable by reflecting the changed nature and size of schemes and responding to financial stresses that can occur with schemes.

1.2 Reference to CAMAC

In a letter of 18 November 2010 (set out in the Appendix), the then Parliamentary Secretary to the Treasurer, the Hon. David Bradbury MP (the PST), referred various matters concerning the regulation of schemes to CAMAC.

In his letter, the PST referred to:

the difficulties that arise for responsible entities (REs), scheme members, and creditors where a [scheme] comes under financial stress.

The PST letter referred to the current lack of certainty with respect to the arrangements for dealing with unviable schemes, pointing particularly to the collapse of a number of significant participants in the agribusiness market:

While the corporate insolvency provisions in the Corporations Act provide creditors and directors with certainty about their rights and obligations, the Corporations Act sets out very few specialised rules regarding the administration of insolvent trusts or trustees. Instead, the administrations of such are determined by a mix of legislation, common law and equitable principles. The lack of clarity has led liquidators to resort often to the Court in order to obtain advice about the legality of future actions.

It is therefore not clear whether the legislative arrangements contained in the Corporations Act are adequate to maintain the confident participation of retail investors in [schemes] because of deficiencies in the way the Act deals with: resolving the consequence, for otherwise viable schemes, of the insolvency of their RE; and what is to occur when the RE is insolvent and the Scheme itself has failed.

The PST letter also stated that:

Informal stakeholder consultations have also raised issues with the general operation of the [schemes] regime, which has not been reviewed since 2001.

The PST letter then referred the following specific matters to CAMAC for consideration and the provision of advice.

Changing the RE of a viable scheme

In some situations, the responsible entity (RE) of a viable scheme may act in a manner, or in some other capacity suffer financial loss, that makes that RE ineligible or unsuitable to continue in its role as operator of the scheme. However, the future of the scheme may be placed in jeopardy through difficulties in immediately securing a suitable replacement RE, given that a scheme cannot continue without an RE.

In this context, the PST letter asked CAMAC to:

examine whether the current temporary RE framework enables the transfer of viable [scheme] businesses where the original RE is under financial stress, and if not whether it should be reformed or replaced.

Restructuring a financially stressed scheme

Companies in financial stress may be placed in voluntary administration (VA), with a view to their possible rehabilitation, rather than be immediately wound up. There is no equivalent procedure for schemes. In consequence, a financially stressed, but potentially viable, scheme may have to be wound up without a formal opportunity to assess the possibility of a compromise or other arrangement that could allow the scheme to continue.

In this context, the PST letter asked CAMAC to:

examine whether REs are unable to restructure a financially viable [scheme] and advise if the current legislative methods available to companies under the Corporations Act should be adapted to managed schemes.

Winding up a scheme

Where a scheme is no longer viable, or otherwise is to be wound up, the question arises how best to ensure a suitable outcome for all affected parties, without the level of procedural complexity and potential disputation that currently can beset the winding up process.

In this context, the PST letter asked CAMAC to:

examine whether the current statutory framework is adequate for the winding up of a [scheme], and agribusinesses in particular, and whether it provides the necessary guidance for liquidators, creditors, investors and growers

advise what legislative amendments should be made if the current legislative framework does not provide the necessary legislative tools with respect to the arrangements for dealing with non-viable [schemes].

Other matters

The PST letter also asked CAMAC to:

examine other proposals to improve Chapter 5C of the Corporations Act, including in relation to: convening scheme meetings; cross-guarantees entered into by REs on behalf of other group members; and statutory limited liability.

1.3 Key distinctions

This report draws two distinctions that are central to an understanding of how schemes operate and to any consideration of the matters referred to in the reference to CAMAC:

- the distinction between pooled schemes and common enterprise schemes
- the distinction between sole-function REs and multi-function REs.

1.3.1 Pooled schemes and common enterprise schemes

The statutory definition of ‘managed investment scheme’ refers to contributions from investors being ‘pooled or used in a common enterprise’.²

Pooled schemes involve contributions by scheme members being pooled and becoming scheme property, for use in scheme

² Paragraph (a)(ii) of the s 9 definition of ‘managed investment scheme’.

investments or otherwise to operate the scheme. Schemes of this type are typically established as trust-based investment arrangements, with scheme members playing no active role in the affairs of the scheme.

Common enterprise schemes involve the use of member contributions in a common enterprise that constitutes the scheme, without those contributions being pooled. In these forms of entrepreneurial arrangements, a distinction must be drawn between scheme property and property owned by individual scheme members that is used in the operation of the scheme. Schemes of this type are typically established as contract-based arrangements, with scheme members playing an active entrepreneurial role to some degree, at least in theory.

1.3.2 Sole-function and multi-function REs

A sole-function RE is an entity whose only role is to operate one particular scheme.

A multi-function RE is an entity that is the operator of more than one scheme or is the operator of at least one scheme and has other dealings in its own right, such as conducting its own business. The legislation contemplates schemes being operated by multi-function REs.³

1.4 Terminology

For ease of reference, throughout this report:

- *affairs of a scheme* refers to all agreements forming part of a scheme
- *AFSL* refers to an Australian financial services licence, issued by ASIC, and authorising an RE to operate a scheme
- *agreement* refers to any legally binding contract, transaction, understanding or other arrangement

³ Subparagraph 601FC(1)(i)(ii) refers to an RE holding scheme property ‘separately from property of the responsible entity and property of any other scheme’.

- *agreement forming part of a scheme* refers to any agreement entered into by the RE pursuant to its role in operating the scheme, and any agreement entered into by a scheme member pursuant to the terms of the scheme
- *common enterprise scheme* refers to a scheme where contributions by members are to be ‘used in a common enterprise’ (para (a)(ii) of the definition of ‘managed investment scheme’ in s 9) (rather than those contributions being placed in a common pool) and where members typically enter into a series of agreements with the RE and/or other parties related to the ongoing operation of the scheme. In practice, this type of scheme may also be referred to as a contract-based scheme or an enterprise scheme
- *DOCA* means a deed of company arrangement, entered into as the result of a corporate VA
- *insolvent scheme* means a scheme where the scheme property is insufficient to meet all the claims that can be made against that property as and when those claims become due and payable
- *limited recourse rights* refers to rights of recovery of a counterparty against an RE, under an agreement with that RE as operator of a scheme, that are limited to the scheme property available to the RE through the exercise of the RE’s indemnity rights and exclude rights of recovery against the personal assets of the RE
- *MIS* refers to the proposed separate legal entity under the SLE Proposal (set out in chapter 3) that would hold all the scheme property and, through its RE as agent, would be the principal to all agreements involving scheme property
- *multi-function RE* means an entity that is the operator of more than one scheme or is the operator of at least one scheme and has other dealings in its own right, such as conducting its own business
- *personal assets of the RE* means all assets of the RE, including assets acquired by the RE through dealings unrelated to its operation of any scheme and any funds that the RE has received through exercise of its indemnity rights against the property of

any scheme that it operates. The term excludes scheme property, and any other property, held on trust by the RE. The term also excludes any unexercised indemnity rights of the RE against scheme property. While as a matter of law these unexercised indemnity rights form part of the personal assets of the RE, they are, for the purposes of this report, not included in this definition, but are separately defined below

- *personal liability of the RE* refers to the obligation of the RE under the current legal framework to meet, from its personal assets, liabilities under agreements into which it enters as operator of a particular scheme and which do not restrict the counterparty to limited recourse rights
- *pooled scheme* refers to a scheme where contributions by members ‘are to be pooled’ (para (a)(ii) of the definition of ‘managed investment scheme’ in s 9), typically in a trust-based investment arrangement, and where members typically do not enter into further agreements with the RE or any other party related to the ongoing operation of the scheme. In practice, this type of scheme may also be referred to as a passive or trust-based scheme
- *RE* means the responsible entity of a scheme, as defined in s 9
- *sole-function RE* means an RE whose only function is to operate one scheme
- *scheme* means a managed investment scheme, as defined in s 9
- *scheme administrator/liquidator* means the person appointed to administer/wind up a scheme, as proposed in this report
- *scheme creditors* means all persons who have claims as creditors by virtue of having entered into agreements with the RE as operator of the scheme, except where the RE is acting as agent for scheme members. The rights of particular scheme creditors may differ, depending upon whether they have agreed to having only limited recourse rights (see above)
- *scheme members/members of a scheme* means those persons who, pursuant to the definition of managed investment scheme in s 9, have contributed money or money’s worth as

consideration to acquire rights to benefits produced by the scheme

- *scheme property/property of a scheme* means all property coming within the definition of ‘scheme property’ in s 9
- *subrogation remedy* means the process by which counterparties to agreements with the RE as operator of a scheme can indirectly gain access to the property of that scheme through the indemnity rights of the RE regarding that property, as a means of satisfying their claims under those agreements
- *TRE* means a temporary responsible entity appointed by the court to operate a scheme on an interim basis
- *unexercised indemnity rights of an RE* means rights of an RE, not yet exercised, to be indemnified out of the property of a scheme in consequence of operating that scheme
- *VA* means voluntary administration. A corporate VA is regulated under Part 5.3A of the Corporations Act.

1.5 The review process

To invite and facilitate the expression of views from interested parties on the matters referred to CAMAC, the Committee published a discussion paper *Managed Investment Schemes* in June 2011.

In response to the invitation in the discussion paper, CAMAC received submissions from:

- Allens Arthur Robinson (AAR)
- Alliton Securities
- Ashurst Australia (formerly Blake Dawson)
- Australian Compliance Institute
- Australian Securities and Investments Commission (ASIC)
- Baker & McKenzie

- Garry Bigmore QC, Samuel Hopper & Matthew Kennedy, Victorian Bar
- Chartered Secretaries Australia (CSA)
- Clarendon Lawyers
- Financial Services Council
- Freehills
- Henry Davis York
- Insolvency Practitioners Association (IPA)
- Alan Jessup, Partner, Piper Alderman
- McCullough Robertson
- McMahon Clarke Legal
- Primary Securities Ltd
- Property Council of Australia
- Property Funds Association of Australia
- The Trust Company
- Richard Wilkins.

A summary of submissions on each of the issues is included in this report. The submissions are published in full on the CAMAC website.

CAMAC was greatly assisted in its consideration of issues related to schemes by the information and views provided by respondents. The Committee expresses its thanks to all those who participated in this consultation process.

CAMAC also acknowledges, with appreciation, the work of the CAMAC schemes subcommittee (Bob Seidler (chair), Pamela Hanrahan, James Marshall, Michael Murray, Geoff Nicoll and David Proudman) on this review.

1.6 Outline of the CAMAC position

1.6.1 Issues under the current legal framework

The problem of common enterprise schemes

In considering the issues raised by this reference, CAMAC observes that the problems encountered with the operation of schemes in recent years have arisen principally, if not exclusively, in the context of common enterprise schemes. These problems centre on the difficulties that can arise, particularly when a common enterprise scheme or its RE is in financial stress, from the intermingling of the affairs and property of the scheme itself and of its members.

Recent experience with the collapse of some agribusiness common enterprise schemes points to the possibility of confusion arising in attempting to untangle these arrangements, with a range of involved parties, including scheme members, each seeking to assert what they perceive to be their proprietary and other rights and attempting to determine the way forward, often in an environment of conflict and resort to litigation.

CAMAC has considered whether an effective way to avoid these problems arising in the first place might be to permit only pooled schemes.

CAMAC notes that this option was not adopted when the current Chapter 5C of the Corporations Act was introduced in 1998. At that time, however, it may not have been possible to anticipate the extent to which schemes would continue to develop beyond primarily passive pooled investment vehicles to encompass large business enterprises, adopting the common enterprise scheme structure for taxation and other reasons.

More recent experience suggests that many of the problems encountered in attempting to deal with schemes in financial stress, including how best to respond to the various proprietary and other claims of scheme members, may have been avoided if the types of permissible schemes had been limited to pooled schemes. Entrepreneurial activities in which investors sought a greater personal proprietary or other involvement could have adopted a corporate based structure, although it is recognised that a corporate entity is not as effective from a taxation perspective as a collective

investment vehicle in attracting a wide range of investors with different tax profiles.

CAMAC considers that, while it may not be feasible to require the redesign or termination of existing common enterprise schemes, there is considerable merit in forestalling future problems through a legislative initiative to prohibit the creation of new common enterprise schemes. This legislative initiative would be equally necessary under the current legal framework or under the SLE Proposal (see Section 1.6.2), if adopted.

The problem of multi-function REs

A further problem that became apparent during the course of the review was the potential for complexity where schemes were run by multi-function REs. For instance, the task of administering an insolvent multi-function RE can be made more difficult by having to disentangle its own dealings in its personal capacity from its dealings as operator of a number of schemes, and then determine which dealings as scheme operator go with which schemes. This process can be further complicated by disputation amongst a range of affected parties about the nature of their rights and remedies where the RE fails.

This potentially complex untangling task would not arise if schemes could be operated only by sole-function REs.

CAMAC acknowledges that requiring all existing schemes to be operated only by a sole function RE would require a considerable number of new REs to be registered, each of which would have to hold an Australian financial services licence (AFSL).⁴ Also, it would be necessary to ensure that the transfer of scheme property from a multi-function RE to a new RE of the scheme was tax neutral, including being exempt from stamp duty.

While it may not be feasible to require all existing schemes to be operated by sole-function REs, CAMAC sees merit in a legislative initiative to require each new scheme to be operated only by a sole-function RE. However, this legislative initiative would not be necessary if the SLE Proposal (see Section 1.6.2) were adopted.

⁴ ASIC indicated that in July 2012 there were 487 REs, operating some 3950 registered schemes.

Specific matters raised in the reference

In addition to these general considerations, CAMAC also makes a series of specific recommendations on various matters arising out of the terms of reference. For instance, CAMAC recommends, for each scheme, the creation of a definitive register of the affairs of that scheme and a definitive register of the property of that scheme. Clear identification of the affairs and property of each scheme is essential to the effective day-to-day operation of a scheme, the transfer of the RE of a viable scheme, the restructuring of a financially stressed but potentially viable scheme, and the winding up of a scheme.

These recommendations are summarised in Section 1.6.3.

1.6.2 Alternative legal framework: the Separate Legal Entity (SLE) Proposal

During the course of the review, and in response to the problems identified under the current legal framework, CAMAC has developed an alternative framework for the regulation of schemes, described as the Separate Legal Entity (SLE) Proposal, which is set out in chapter 3 of this report.⁵

The SLE Proposal would also create a greater alignment between commercial enterprises operated through a corporate vehicle and those enterprises operated through a scheme, making it easier for the community to undertake business activity and simplifying legislative reform in the future.

In essence, under the SLE Proposal, each scheme would involve a registered MIS, which would be a separate legal entity, distinct from the RE or members of the scheme. The MIS, not the RE (as under the current legal framework), would hold legal title to all scheme property and would be the principal in all agreements entered into by the RE as operator of the scheme. The RE would act only as the agent of the MIS, not as principal, when entering into these agreements.

⁵ CAMAC acknowledges the role of the Alternative Proposal put forward in the submission by Freehills in the development of the SLE Proposal.

The SLE Proposal would simplify the regulatory structure for schemes, while overcoming many of the problems that have arisen under the current legal framework. It would:

- ensure the full separation of the property, affairs and liabilities of a scheme from those of its RE, thereby avoiding liability and other overlaps that can occur under the current legal framework. Given this separation, it would be irrelevant, in terms of legal consequences, whether a scheme was operated by a sole-function or by a multi-function RE, thereby avoiding any need to restrict the use of multi-function REs
- provide counterparties to agreements with direct rights against scheme property, which are not available to them under the current legal framework
- assist the process of replacing the RE of an ongoing scheme, as a TRE or new RE would not be subject to personal obligations and liabilities for agreements entered into by a former RE (who would only be an agent), as is the case under the current legal framework (where the RE acts as principal)
- simplify the external administration process, including for any VA or separate winding up procedures for schemes. The full separation of the affairs of a scheme from those of its RE would avoid the types of external administration overlap problems between a scheme and its RE that can arise under the current legal framework.

While the simplified regulatory structure under the SLE Proposal would resolve many difficulties, the key problem under common enterprise scheme arrangements of the possible intermingling of member and scheme affairs and property would remain. CAMAC therefore takes the same approach under the SLE Proposal as under the current legal framework, namely a recommendation to forestall the creation of new common enterprise schemes.

CAMAC puts forward in chapter 3 a number of options for the introduction of the SLE Proposal. Its preferred position is that the SLE Proposal be adopted for both common enterprise schemes and pooled schemes, and that there be no exemption for existing schemes. CAMAC recognises that applying that regulatory framework to existing schemes would first require amendments to

revenue legislation to ensure that the transfer of legal title to scheme property from an RE to an MIS is treated as a form of tax-free rollover of property, including being exempt from stamp duty.

For the SLE Proposal to operate, it would also be necessary to amend the taxation legislation to ensure that each MIS is taxed at the investor level rather than at the corporate level in the same manner as a passive scheme is currently taxed.

Specific matters raised in the reference

In addition to these general considerations, CAMAC also makes a series of specific recommendations on various matters arising out of the terms of reference, which are summarised below. Some of these recommendations would be unnecessary if the SLE Proposal was adopted. Other recommendations deal with issues concerning the effective operation of schemes that would arise in any event, including the proposals for definitive registers of the affairs and property of each scheme.

In putting forward each recommendation in this report, CAMAC has taken into account the implications for the recommendation if the SLE Proposal were adopted.

1.6.3 Specific recommendations

Proposed key legislative reforms

CAMAC recommends:

- every RE be obliged to maintain, for each scheme that it operates, a definitive register of the affairs of that scheme⁶
- every RE be obliged to maintain, for each scheme that it operates, a definitive register of the property of that scheme⁷
- the ASIC record of registration identifying the party who is the RE be definitive⁸

⁶ Section 4.3.4.

⁷ Section 4.4.3.

⁸ Section 4.6.4.

- in lieu of the subrogation remedy, counterparties to agreements with the RE as operator of a scheme have rights to claim directly against the scheme property⁹ (irrelevant under the SLE Proposal)
- any provision in a scheme constitution, or otherwise, that affords an RE an indemnity for any form of maladministration on its part in relation to that scheme be unenforceable.¹⁰

Changing the RE of a viable scheme

CAMAC recommends:

- an incumbent RE be obliged to provide reasonable assistance to a prospective RE in certain circumstances¹¹
- restrictions be placed on an RE receiving remuneration in advance¹²
- controls be introduced to prevent an RE from becoming entrenched¹³
- changes be implemented to voting requirements for scheme members to replace the RE of an unlisted scheme¹⁴
- the court be given an extended power to appoint a TRE¹⁵
- the court be empowered to appoint as a TRE any person considered suitable¹⁶
- restrictions be placed on the transfer of rights, obligations and liabilities (s 601FS) to a TRE¹⁷ (irrelevant under the SLE Proposal)

⁹ Section 4.7.5.

¹⁰ Section 4.8.3.

¹¹ Section 5.2.3.

¹² Section 5.3.2.

¹³ Section 5.3.3.

¹⁴ Section 5.4.3.

¹⁵ Section 5.5.3.

¹⁶ Section 5.6.4.

¹⁷ Section 5.7.4.

- the powers of the court, upon appointment of a TRE, be expanded¹⁸
- modifications be made to s 601FS to avoid unintended consequences¹⁹ (irrelevant under the SLE Proposal)
- the duties of a TRE be modified²⁰
- the court be empowered to determine the remuneration of a TRE²¹
- the TRE be obliged to provide reasonable assistance to a prospective RE²²
- the TRE be given the power to place a scheme in VA²³
- the TRE be obliged to assist an external administrator.²⁴

Restructuring a financially stressed scheme

CAMAC recommends:

- the legislation define a scheme as being insolvent where the scheme property is insufficient to meet all the claims that can be made against that property as and when those claims become due and payable²⁵
- a scheme VA procedure be introduced, with the approach under the SLE Proposal being the preferred option²⁶
- the ambit of a scheme moratorium include all rights or claims concerning the RE, scheme members or external parties that might affect the ability of the scheme administrator to restructure the affairs of the scheme²⁷

¹⁸ Section 5.7.4.

¹⁹ Section 5.8.3.

²⁰ Section 5.9.3.

²¹ Section 5.10.3.

²² Section 5.11.4.

²³ Section 5.11.4.

²⁴ Section 5.11.4.

²⁵ Section 6.3.2.

²⁶ Sections 6.3-6.4.

²⁷ Section 6.5.3.

- voting rights on one or more scheme deeds be determined in the first instance by the scheme administrator, with the administrator or affected parties having standing to apply to the court to challenge the administrator's determination²⁸
- the court be given a residual power to order that a scheme be discontinued or wound up²⁹
- only registered liquidators be eligible to be scheme administrators³⁰
- a scheme administrator have similar functions, powers and liabilities to those of a corporate administrator³¹
- the court be empowered to determine the remuneration of the scheme administrator if affected parties cannot agree³²
- the powers of the court in the VA of a scheme include the equivalent of s 447A³³
- the scheme administrator or the scheme deed administrator have standing to apply to the court for the appointment of a TRE.³⁴

Winding up a scheme

CAMAC recommends:

- scheme members be able to approve the winding up of a scheme by 75% of the votes cast, provided the votes in favour of the winding up constitute at least 25% of the total votes of scheme members³⁵
- the court be empowered to give directions whenever it thinks it 'appropriate' to do so³⁶

²⁸ Section 6.6.3.

²⁹ Section 6.7.3.

³⁰ Section 6.8.

³¹ Section 6.8.2.

³² Section 6.8.3.

³³ Section 6.9.3.

³⁴ Section 6.10.3.

³⁵ Section 7.2.2.

³⁶ Sections 7.2.6, 7.5.4.

- there be provision for a solvent winding up of a scheme to become an insolvent winding up³⁷
- only a registered liquidator be permitted to conduct the winding up of an insolvent scheme³⁸
- the court be given a power to wind up a scheme on the basis that it is insolvent, and, in consequence, the unsatisfied execution ground for winding up a scheme be repealed³⁹
- where an insolvent scheme and its insolvent RE are being wound up without first going through a VA procedure, the liquidator of the RE administer a combined winding up, unless or until the liquidator determines otherwise, with rights of affected parties to apply to the court for a determination on this matter⁴⁰
- the Corporations Act provide general procedures for the winding up of an insolvent scheme, comparable to those for the winding up of an insolvent company⁴¹
- there be a statutory order of priorities in the winding up of a scheme, providing a first priority for payments to a TRE and thereafter an order of priorities based on that provided for companies in s 556 (which subsequent order of priorities would commence with an equal ranking for payments to a scheme administrator, a scheme deed administrator or a scheme liquidator)⁴²
- a former RE or a new RE with claims against scheme property under its indemnity rights be treated as an unsecured, non-priority, creditor of the scheme⁴³
- there be voidable transaction provisions applicable in the winding up of an insolvent scheme.⁴⁴

³⁷ Section 7.2.7.

³⁸ Sections 7.2.7, 7.3.2, 7.4.3.

³⁹ Section 7.4.1.

⁴⁰ Section 7.4.2.

⁴¹ Section 7.5.3.

⁴² Section 7.5.5.

⁴³ Section 7.5.5.

⁴⁴ Section 7.5.6.

Other matters

CAMAC recommends:

- scheme members be given an extended power to call scheme meetings⁴⁵
- scheme members be given statutory limited liability (which should not be subject to any contrary provision in a scheme constitution).⁴⁶

In response to matters raised in the terms of reference, CAMAC:

- recommends against ASIC having a power to convene a meeting of scheme members⁴⁷
- recommends against an obligation to hold an annual general meeting of scheme members⁴⁸
- recommends against additional controls regarding guarantees given by REs in their personal capacity or as operator of a scheme.⁴⁹

1.6.4 Other proposals

In addition to the specific matters raised in the PST letter, CAMAC was asked to:

examine other proposals to improve Chapter 5C of the Corporations Act.

Various respondents to the CAMAC discussion paper raised proposals concerning the functioning of schemes, over and above the issues dealt with in this report. Included in the submissions were references to matters considered in a series of papers in 2001-2002 on schemes by Mr M Turnbull,⁵⁰ Treasury⁵¹ and the Parliamentary Joint Committee on Corporations and Financial Services.⁵²

⁴⁵ Section 8.2.3.

⁴⁶ Section 8.4.3.

⁴⁷ Section 8.2.3.

⁴⁸ Section 8.2.3.

⁴⁹ Section 8.3.3.

⁵⁰ *Review of the Managed Investments Act 1998* (December 2001).

These proposals, including matters considered in those papers, will be set out in a further CAMAC review, with an invitation to make submissions on the proposals.

1.7 The Advisory Committee

The Advisory Committee is constituted under the *Australian Securities and Investments Commission Act 2001*. Its functions include, on its own initiative or when requested by the Minister, to provide advice to the Minister about corporations and financial services law and practice.

The members of the Advisory Committee are selected by the Minister, following consultation with the States and Territories, in their personal capacity on the basis of their knowledge of, or experience in, business, the administration of companies, financial markets, financial products and financial services, law, economics or accounting.

The members of CAMAC are:

- Joanne Rees (Convenor)—Chief Executive Officer, Allygroup, Sydney
- Belinda Gibson—Deputy Chairman, Australian Securities and Investments Commission (nominee of the ASIC Chairman to May 2012)
- David Gomez—Principal, Merit Partners, Darwin
- Jane McAloon—Group Company Secretary, BHP Billiton Limited, Melbourne
- Alice McCleary—Company Director, Adelaide
- Denise McComish—Partner, KPMG, Perth
- Marian Micalizzi—Chartered Accountant, Brisbane

⁵¹ *Review of the Managed Investments Act 1998: Consultation Paper* (April 2002).

⁵² *Report on the Review of the Managed Investments Act 1998* (December 2002).

- Michael Murray—Legal Director, Insolvency Practitioners Association, Sydney
- Geoffrey Nicoll—Co-Director, National Centre for Corporate Law and Policy Research, University of Canberra
- John Price—Commissioner, Australian Securities and Investments Commission (nominee of the ASIC Chairman from May 2012)
- Ian Ramsay—Professor of Law, University of Melbourne
- Robert Seidler AM—Consultant, Ashurst Australia, Sydney
- Greg Vickery AM—Special Counsel, Norton Rose Australia, Brisbane.

A Legal Committee has been constituted to provide expert legal analysis, assessment and advice to CAMAC in relation to such matters as are referred to it by CAMAC.

The members of the Legal Committee are selected by the Minister, following consultation with the States and Territories, in their personal capacity on the basis of their expertise in corporate law.

The members of the Legal Committee are:

- Greg Vickery AM (Convenor)—Special Counsel, Norton Rose Australia, Brisbane
- Rosey Batt—Principal, Rosey Batt and Associates, Adelaide
- Lyn Bennett—Partner, Hunt & Hunt, Darwin
- Elizabeth Boros—Barrister-at-Law, Melbourne
- Damian Egan—Partner, Murdoch Clarke, Hobart
- Jennifer Hill—Professor of Law, University of Sydney
- James Marshall—Partner, Ashurst Australia, Sydney
- David Proudman—Partner, Johnson Winter & Slattery, Adelaide

- Brian Salter— General Counsel, AMP, Sydney
- Rachel Webber—Special Counsel, Jackson McDonald, Perth.

The Executive comprises:

- John Kluver—Executive Director
- Vincent Jewell—Deputy Director
- Thaumani Parrino—Office Manager.

2 Current position

This chapter summarises the various types of scheme and provides an overview of their regulation.

2.1 Economic role of schemes

Schemes are a means of pooling, or using in a common enterprise, wholesale or retail investors' funds or other property for commercial projects. These include:

- listed real property and infrastructure schemes
- unlisted property trusts and syndicates, and mortgage funds
- cash, bonds, equity and multi-sector managed funds
- timeshare, horse-breeding or racing, serviced strata and film schemes
- various agribusinesses, including forestry.

Some schemes are principally investment vehicles, while others are enterprises in their own right.

The managed funds industry, which includes various types of schemes, forms a substantial part of the Australian economy.⁵³ For instance, listed schemes with a capitalisation of over \$100 billion

⁵³ As summarised by P Hanrahan in *Managed Investments Law and Practice* (CCH) at ¶1-100:

Schemes range in size from multi-billion dollar property, equity, and cash trusts to small agricultural projects and syndicates. The funds management industry (retail and wholesale) is a significant part of the national economy. Total unconsolidated assets held by fund managers as at June 2011 were just under \$1.855 trillion; this figure includes \$1.29 trillion in superannuation funds. Public offer (retail) unit trust assets totalled \$282,833m, made up of \$124,890m in listed property trusts, \$35,243m in listed equity trusts, \$3,715m in unlisted property trusts, \$97,920m in unlisted equity trusts, \$4,725m in unlisted mortgage trusts (down from a high of \$9,652m in December 2007) and \$16,340m in other unlisted trusts. The total assets of cash management trusts was \$24,236m (down from \$50,732m in June 2008): see Australian Bureau of Statistics 5655.0 Managed Funds Australia June 2011.

constitute some 8% of the total market capitalisation of securities listed on the ASX market.⁵⁴ Some 80% of investment-grade commercial real estate, comprising office buildings, shopping centres and industrial facilities, are held in schemes. Most major infrastructure projects that involve private sector investment utilise schemes.

A scheme in the form of a trust is a tax-efficient vehicle for collective investments, in that investors with different tax profiles (for instance, companies, pension funds, individuals) can invest together without adversely affecting their tax positions.

The taxation regime for passive trusts in Australia means that they can be used as vehicles for a greater range of collective investments than in other jurisdictions, such as the United States and Japan. The burgeoning use of schemes in Australia can be mainly attributed to:

- the compulsory superannuation scheme generating exponentially increasing investible funds and the need to invest such funds in a variety of asset classes to manage volatility, and
- the tax environment referred to above, which permits trusts, as schemes, to be used for investment purposes without restriction on the nature of the investment.

For tax and other purposes, an enterprise may be conducted through a combined scheme/corporate structure. Under a simple ‘stapled’ security arrangement,⁵⁵ the company takes the active role of

⁵⁴ Approximately 68% of listed schemes are Real Estate Investment Trusts (REITS), with the remainder being infrastructure trusts, exchange-traded funds (ETFs) and Listed Investment Trusts.

Listed schemes are subject to various ASX Listing Rule requirements. A court may order that the RE of a listed scheme comply with the Listing Rules: s 793C.

⁵⁵ A stapled security is a type of financial instrument that combines shares in a company with units in a scheme. These combined securities can only be purchased and sold together. The stapled structure has been intensively used in Australia by real estate investment trusts and infrastructure funds. At the end of 2011, 15 of 18 listed infrastructure funds and 28 of 49 real estate funds had stapled security structures: ‘Why Stapled Securities?’ *Financial Regulation Discussion Paper Series* FRDP 2012-3 (4 June 2012) (at p 1). In relation to the tax advantages of stapled structures, that paper notes (at p 3):

Because the trust is a “pass-through” entity for tax purposes, income it receives is not subject to company tax as long as paid out to unit holders. Consequently lease payments by the company reduce its taxable income and company tax paid, and increase the income of the trust on which company tax is not paid.

operating the enterprise, while the property of the enterprise is held passively through the scheme structure. Some stapled arrangements may involve multiple schemes or companies. Where more than one scheme is involved, they may have the same RE or separate REs.

2.2 Legal framework

The current legal structure for schemes, primarily set out in Chapter 5C of the Corporations Act, was introduced by the *Managed Investments Act 1998*. The design of that legislation took into account the joint Australian Law Reform Commission (ALRC)/Companies and Securities Advisory Committee (CASAC)⁵⁶ report *Collective Investments: Other People's Money* (1993) (the ALRC/CASAC report).⁵⁷

2.2.1 Legal structure of a scheme

Basic features

While there is no prescribed structure for a scheme, the various types of trust, contractual, limited partnership⁵⁸ and other entities have key common features, including:

- the contributions⁵⁹ of members of the scheme are either ‘pooled’ (typically in a trust-based arrangement) or are ‘used in a common enterprise’ (typically in a contract-based arrangement).⁶⁰ Most schemes are either pooled schemes or common enterprise schemes,⁶¹ though schemes can combine both types of arrangement.⁶² Scheme members receive

⁵⁶ In 2002, the name was changed to the Corporations and Markets Advisory Committee (CAMAC).

⁵⁷ Collective investment vehicles were previously regulated as ‘prescribed interests’, which involved an approved deed, with responsibilities for the scheme divided between a management company and a trustee.

⁵⁸ See, for instance, *Re Willmott Forests Ltd (No 2)* [2012] VSC 125 at [73]-[74].

⁵⁹ Contributions can be in money or money’s worth: subparagraph (a)(i) of the definition of ‘managed investment scheme’ in s 9.

⁶⁰ Subparagraph (a)(ii) of the definition of ‘managed investment scheme’ in s 9.

⁶¹ This distinction between trust-based and contract-based structures was drawn by the Companies and Securities Law Review Committee (CSLRC) in 1987, using the terms fiduciary [trust] and non-fiduciary [contract] prescribed interests: CSLRC *Discussion Paper No 6—Prescribed Interests* (1987), Ch 4.

⁶² For instance, in *Commonwealth Bank of Australia v Fernandez* [2010] FCA 1487 at [86], the Federal Court referred to members in a common enterprise scheme having ‘an interest in scheme assets that are acquired with pooled money’.

contractual or property ‘interests’ in the scheme,⁶³ being ‘financial products’ regulated by Chapter 7 of the Corporations Act

- members do not have day-to-day control over the operation of the scheme (though under the terms of a scheme’s constitution they may have the right to be consulted or to give directions in some instances)⁶⁴
- the scheme is operated by the RE,⁶⁵ given that a scheme is not a separate legal entity and therefore cannot enter into legal agreements in its own right. In operating the scheme, the RE acts as the principal to agreements with external parties, except where (as in some common enterprise schemes) the scheme members themselves transact as the principals, which may involve using the RE as their agent.

Some arrangements are specifically excluded from the definition of a scheme.⁶⁶

The concept of ‘scheme property’ covers:

- contributions of money or money’s worth to the scheme. If what a member contributes to a scheme is rights over property, the

⁶³ Subparagraph (a)(i) of the definition of ‘managed investment scheme’ in s 9.

⁶⁴ Subparagraph (a)(iii) of the definition of ‘managed investment scheme’ in s 9.

⁶⁵ s 601FB(1). One of the key initiatives recommended in the ALRC/CASAC report, and implemented in Chapter 5C, was the introduction of a single licensed RE to operate the scheme and hold scheme property on trust for scheme members. The RE replaced the previous two-tiered trustee and management company structure for the operation of these schemes.

⁶⁶ The definition of ‘managed investment scheme’ in s 9 of the Corporations Act sets out a number of specific exclusions. ASIC has pointed out that, in general, only investments that are ‘collective’ are schemes. Some examples given by ASIC of investments that are not schemes include:

- regulated superannuation funds
- approved deposit funds
- debentures issued by a body corporate
- barter schemes
- franchises
- direct purchases of shares or other equities
- schemes operated by an Australian bank in the ordinary course of banking business (eg term deposit).

See further www.asic.gov.au

rights in the property that the member retains do not form part of the scheme property⁶⁷

- money borrowed or raised by the RE for the purposes of the scheme
- property acquired, directly or indirectly, with, or with the proceeds of, contributions or money referred to above
- income and property derived, directly or indirectly, from contributions, money or property referred to above.⁶⁸

Despite this apparently wide definition, whether property used in connection with a scheme is ‘scheme property’ as defined may depend on whether the scheme is one in which members pool their funds or is one in which members use their funds in a common enterprise. Common enterprise schemes are more likely than pooled schemes to have property of the members used in the enterprise.

Pooled schemes and common enterprise schemes

Schemes that hold real estate or other assets for investment purposes are generally structured as trust-based pooled schemes, largely for tax reasons. In the listed property and infrastructure sectors, interests in these pooled schemes are often stapled to shares in an operating company, with the trust part of the structure owning the real estate or infrastructure. Scheme members hold shares in the corporate part of the structure and have a beneficial interest in the whole of the property of the trust.

By contrast, common enterprise schemes are often structured as a series of bilateral or multilateral executory agreements between the member, the RE and various external parties. The ‘scheme’ in that case is not a pool of assets under management, but rather the common enterprise carried out over time in accordance with those agreements. For instance, for taxation or other reasons, various agribusiness common enterprise schemes were structured so that scheme members (‘growers’) operated their agribusiness investment in their own right, entering into agreements with the RE or external parties to perform the cultivation and management activities

⁶⁷ Note 1 to the definition of ‘scheme property of a registered scheme’ in s 9.

⁶⁸ Definition of ‘scheme property’ in s 9.

associated with the member's enterprise. Scheme members would hold various forms of proprietary or contractual interests in allocated parcels of land, which may be owned by an external party.⁶⁹ In that type of common enterprise scheme, complex problems can arise in determining the nature of the rights of scheme members, and clearly distinguishing during the operation of the scheme between the

⁶⁹ In *BOSI Security Services Limited v Australia and New Zealand Banking Group Limited & Ors* [2011] VSC 255, at [1]-[3] and [12]-[14], the Court described the structure of one agribusiness involving a common enterprise as follows:

The Timbercorp group of companies went into administration on 23 April 2009. On 29 June 2009, the creditors voted at their second meeting for the companies to be wound up and the companies, which included the second defendant ("AL"), were placed into liquidation. ...

Before liquidation, the Timbercorp group had established, managed and operated several horticultural managed investment schemes. These schemes had included managed investment schemes for the cultivation and harvesting of almonds for commercial gain. Five of the schemes (collectively "the Almond Projects") had used commercial almond orchards established by AL on its land, which AL made available for the purposes of the projects. Investors in these projects ("growers") subscribed for interests in "Almondlots", which carried rights to use and occupy AL's orchards for the terms of the projects of which they were members ("the growers' rights").

All of the Almond Projects had many years left to run when the Timbercorp group went into external administration but the insolvency of the Timbercorp group had the consequence that the Timbercorp companies could not continue their involvement in the projects. The liquidators brought the projects to an end when they extinguished the growers' rights on 2 December 2009 so that they could sell AL's land, almond trees and water licences ("the Almond Assets") free of any encumbrance on title. ...

... At the time that the Timbercorp group was placed under administration, the group had thirty three managed investment schemes registered with the Australian Securities and Investments Commission ("ASIC") under Part 5C of the Corporations Act 2001 (Cth) ("the Act"). Timbercorp Securities Ltd ("TSL"), a wholly owned subsidiary of TL and the holder of an Australian financial services licence, was the responsible entity ("RE") of these schemes. ...

The registered projects and the 2002 private offer project were conducted on AL's land and used AL's almond orchards and infrastructure, including its water licences and irrigation equipment. Although the legal structures differed, it was a key feature of each project that the Almond Assets remained AL's property. The project documents only gave growers rights to use and occupy AL's property for the terms of their projects for the purpose of cultivating and harvesting almonds.

Growers participated in the projects by subscribing for Almondlots and paying a fee per Almondlot. Subscription was by application and the completion of a power of attorney. By signing the application the grower agreed to be bound by the constituent legal documents governing the project. By completing the power of attorney the grower appointed the attorney to enter into the applicable agreements underpinning the projects on the grower's behalf.

property of the scheme and the property of scheme members used in the enterprise.⁷⁰

Trust and non-trust elements

There are some key trust elements that are applicable to all schemes, whether pooled or common enterprise schemes, in particular:

- the RE holds scheme property on trust for scheme members.⁷¹ It has also been held that, in consequence, an RE is a ‘trustee’ for the purposes of the court’s jurisdiction to provide judicial advice and direction to an RE under relevant state trustee legislation⁷²
- the RE’s rights to recover from scheme property for its remuneration and costs in operating the scheme are derived from the constitution of the scheme and based on trust law indemnity principles.⁷³

On the other hand, there are areas where the legislative structure for schemes differs from the general law of trusts. For instance, the Corporations Act sets out a regime for the transfer of rights, obligations and liabilities where the RE of a scheme changes,⁷⁴ independently of any trust law principles applicable when there is a

⁷⁰ For instance, in *BOSI Security Services Limited v Australia and New Zealand Banking Group Limited & Ors* [2011] VSC 255, the Court held, on the facts, that the members of the common enterprise scheme had only a contractual, not a proprietary, interest in certain land used in the operation of that scheme. Those contractual rights were insufficient to establish their entitlement to share in the proceeds of the sale of that land. In *Re Willmott Forests Ltd (No 2)* [2012] VSC 125 at [59] ff, the Court gave consideration to whether certain freehold and leases should be taken to have been ‘contributed’ to the schemes and therefore would constitute scheme property.

⁷¹ s 601FC(2). There may be a difference of view whether this section only applies to scheme property in fact held by the RE (in which case that property is held on trust) or extends to any scheme property, whether or not in fact held by the RE (in which case all scheme property is deemed to be held by the RE and held on trust).

⁷² *Mirvac and Mirvac Funds* [1999] NSWSC 457 at [41]:

[S]ection 601FC(2) states that the responsible entity holds scheme property (in this case the property of the respective trusts) on trust for scheme members (in this case the respective unitholders). There are therefore express trusts here and each responsible entity clearly falls within the definition of the ‘trustee’ for the purposes of section 63 [of the *Trustee Act 1925* (NSW)]. I see nothing in Chapter 5C of the Corporations Law to suggest that it is intended to exclude the Court’s jurisdiction to provide judicial advice to a responsible entity under general trustee legislation.

See also *Re Elders Forestry Management Ltd* [2012] VSC 287 at [6]-[7].
s 601GA(2).

⁷⁴ ss 601FS, 601FT.

change of trustee.⁷⁵ Also, under general trust law, there is no such thing as the formal winding up of a trust. The trust simply comes to an end in certain circumstances and the property is distributed among the beneficiaries.⁷⁶ By contrast, the legislation regulating schemes contains various provisions for their winding up.⁷⁷

2.2.2 Regulation of schemes

The various Parts of Chapter 5C of the Corporations Act, based to a large extent on recommendations in the ALRC/CASAC report, deal with the regulation of a scheme and its RE.

Registration of a scheme

All schemes must be registered except for ‘private’ schemes and ‘wholesale’ schemes⁷⁸ (the discussion in this paper will deal with registered schemes except where otherwise indicated). The scheme must also have a scheme constitution,⁷⁹ a compliance plan⁸⁰ and, in some instances, a compliance committee.⁸¹ There is provision for the winding up of unregistered schemes.⁸²

Scheme constitution

Each scheme must have a constitution, which must make adequate provision for the consideration to be paid to acquire an interest in the scheme, the powers of the RE to deal with scheme property, the method of dealing with complaints by scheme members, and the winding up of the scheme.⁸³ Various other rights or powers, including the right of the RE to be paid for operating the scheme,

⁷⁵ Some of the legal issues that arise at general law when there is a change of trustee are discussed in V Stathakis & S Harrison, ‘Practical consequences of a change of trustee on receivers and secured creditors’ (2011) 11(8) *Insolvency Law Bulletin* 155.

⁷⁶ See, for instance, *Westfield QLD No. 1 Pty Limited v Lend Lease Real Estate Investments Limited* [2008] NSWSC 516.

⁷⁷ Part 5C.9.

⁷⁸ s 601ED. The process of registration with ASIC is set out in Part 5C.1.

⁷⁹ Part 5C.3.

⁸⁰ Part 5C.4. The Parliamentary Joint Committee on Corporations and Financial Services report *Inquiry into the collapse of Trio Capital* (May 2012) rec 7 makes various recommendations concerning the compliance plan.

⁸¹ Part 5C.5. The Parliamentary Joint Committee on Corporations and Financial Services report *Inquiry into the collapse of Trio Capital* (May 2012) rec 7 makes various recommendations concerning the compliance committee.

⁸² s 601EE.

⁸³ s 601GA(1).

can only be exercised if included in the scheme constitution.⁸⁴ The RE can unilaterally amend the scheme constitution if the RE 'reasonably considers the change will not adversely affect members' rights'.⁸⁵ Scheme members can also amend the constitution by special resolution.⁸⁶

Investing in a scheme

The process of offering interests in a scheme is regulated by various disclosure requirements, including that potential retail investors must be given a product disclosure statement, and other related documents, in advance of any investment.⁸⁷ ASIC has also provided disclosure guidance for various types of schemes, including mortgage schemes, property schemes, infrastructure funds, hedge funds and agribusiness schemes.⁸⁸

Role of the RE

A scheme cannot operate without an RE, which must be a public company that holds an AFSL permitting it to operate the scheme.⁸⁹ ASIC imposes requirements on REs through this licensing system, including that they have available adequate financial resources to provide the financial services covered by their licence.⁹⁰ A scheme

⁸⁴ s 601GA(2)-(4).

⁸⁵ s 601GC(1)(b). The relevant principles concerning the exercise of this power by the RE are set out in *ING Funds Management Ltd v ANZ Nominees Ltd* [2009] NSWSC 404 at [92]-[105], and further summarised in *Re Elders Forestry Management Ltd* [2012] VSC 287 at [53]-[58].

⁸⁶ s 601GC(1)(a). See *Re Elders Forestry Management Ltd* [2012] VSC 287 at [72]-[74].

⁸⁷ An interest in a scheme is a 'financial product' for the purposes of Chapter 7 of the Corporations Act (Part 7.1 Div 3). The disclosure requirements for financial products are set out in Part 7.9. They contain detailed requirements for disclosure to a 'retail client' (as defined in ss 761G, 761GA).

⁸⁸ ASIC Regulatory Guide 45 (mortgage schemes), ASIC Regulatory Guide 46 (unlisted property schemes), ASIC Regulatory Guide 231 (infrastructure entities), ASIC Regulatory Guide 232 (agribusiness schemes) and ASIC Consultation Paper 174 (hedge funds).

⁸⁹ s 601FA. The general obligations of licensees are set out in s 912A.

⁹⁰ See ASIC Regulatory Guide 166 *Licensing: Financial requirements*, Pro Forma 209 *Australian financial services licence conditions* (PF 209) and CO 11/1140 *Financial requirements for responsible entities*. Revised minimum financial standards will apply from November 2012. The aim is to ensure that REs have adequate resources to meet operating costs and there is an appropriate alignment with the interests of scheme members.

may be deregistered by ASIC if it does not have an RE that meets these requirements.⁹¹

The legislation sets out responsibilities and powers of an RE in operating the scheme,⁹² the processes for changing the RE⁹³ and the consequences of any change of RE.⁹⁴

The RE of a scheme must hold scheme property (as defined) separately from the personal assets of the RE and the property of any other scheme.⁹⁵ The RE must also keep financial records that correctly explain transactions and the financial position and performance of the scheme, for the purpose of preparing true and fair financial statements.⁹⁶

An RE, its officers and its employees are subject to various statutory duties in operating a scheme.⁹⁷ Directors of the RE may also be personally liable in some stipulated instances in operating the scheme.⁹⁸ Members of a scheme may have civil remedies against the RE and its directors where the scheme has been mismanaged.⁹⁹ An RE may also seek remedies on behalf of scheme members in various circumstances, including where there has been a breach of trust by a former RE or its officers.¹⁰⁰ In addition, as an RE is a public

⁹¹ s 601PB(1)(a).

⁹² Part 5C.2 Div 1.

⁹³ Part 5C.2 Div 2.

⁹⁴ Part 5C.2 Div 3.

⁹⁵ s 601FC(1)(i). The compliance plan of a scheme must set out the arrangements for ensuring that the requirement for separation of assets is complied with (s 601HA(1)(a)).

⁹⁶ s 286.

⁹⁷ ss 601FB–601FE. The duties of officers of the RE, set out in s 601FD, include to take all reasonable steps to ensure that the RE complies with the Corporations Act, any conditions imposed on the RE in its AFSL, the scheme's constitution and the scheme's compliance plan.

⁹⁸ s 197.

⁹⁹ See, for instance, ss 601MA, 1324, 1325.

¹⁰⁰ See, for instance, ss 1317J(2) and 1317H. An RE may also act under general law principles to protect the interests of scheme members, and in some circumstances may be under a duty to do so. For instance, in *Young v Murphy* (1994) 12 ACLC 558 at 562, the Court observed that:

The standing of a trustee to take proceedings to have a breach of trust redressed against a trustee or former trustee or a stranger who has become liable to redress a breach of trust is well recognised. Not only may a trustee take such proceedings, but he runs the risk of himself committing a breach of trust if he fails to do so.

See also *Permanent Trustee Australia Ltd v Perpetual Trustee Co Ltd* (1994) 15 ACSR 722.

company, its directors have the same duties as the directors of any other company,¹⁰¹ including a duty to prevent the RE from trading while insolvent.¹⁰²

Any right of an RE to be paid remuneration out of the property of a scheme must be specified in the scheme constitution and be available only in relation to the proper performance by the RE of its duties.¹⁰³

The annual reporting requirements applicable to public and other companies also apply to schemes.¹⁰⁴ Likewise, the requirements for maintaining financial records applicable to companies apply to schemes.¹⁰⁵ However, there is no requirement that an annual general meeting of scheme members be held.

The RE of a listed scheme is also subject to the ASX Corporate Governance Council *Corporate Governance Principles and Recommendations*.

Replacement of the RE

There are procedures for replacing an RE, including the appointment of a temporary responsible entity (TRE) as an interim measure while a new RE is sought.¹⁰⁶ A common goal of these procedures is to avoid a scheme being without an RE for any period of time, given that the role of the RE is to operate the scheme.¹⁰⁷

Where an RE is replaced, the rights, obligations and liabilities of the outgoing RE under agreements it has entered into (or has inherited from any prior RE) as operator of the scheme are transferred to the incoming RE (including any TRE) through a statutory novation

¹⁰¹ The general duties are set out in Part 2D.1, in particular ss 180–184.

¹⁰² s 588G. Directors who fail to prevent the RE from incurring debts while insolvent are personally liable for any loss or damage suffered by creditors (s 588J), with criminal liability where this failure was dishonest (s 588G(3)).

¹⁰³ s 601GA(2).

¹⁰⁴ Part 2M.3.

¹⁰⁵ Part 2M.2.

¹⁰⁶ Part 5C.2 Div 2.

¹⁰⁷ s 601FB(1).

process.¹⁰⁸ The ostensible purpose of this transfer is to ensure that the rights of counterparties are not affected where the RE of a scheme changes. Except when an RE is acting as agent for scheme members (who then become the principals), the RE transacts as the principal in operating a scheme. As principal, the RE personally takes on the rights, obligations and liabilities under each agreement it enters into as operator of the scheme, unless the counterparty agrees otherwise. These personal rights, obligations and liabilities of an RE are transferred to a TRE or new RE through the novation process.

Position of scheme members

By definition, members of a scheme have no day-to-day control over the operation of the scheme.¹⁰⁹ However, meetings of scheme members may be called for various purposes, including to replace the RE,¹¹⁰ to alter the scheme constitution,¹¹¹ to approve various related party financial benefits,¹¹² or to direct that the scheme be wound up.¹¹³ There are statutory procedures for calling and holding meetings, as well as voting on resolutions and gaining access to the minutes of members' meetings.¹¹⁴

Scheme members do not have an automatic right to inspect scheme accounts or other documents, unless this right is provided for in the scheme constitution or some other scheme document. However, the court may order that a scheme member have access to books of the scheme if the court is satisfied that the applicant is acting in good

¹⁰⁸ ss 601FS, 601FT. What is involved in the concept of rights, obligations and liabilities, and what agreements might be covered under this provision, are discussed in *Investa Properties Ltd* [2001] NSWSC 1089 at [11], *Syncap Management (Rural) Australia Ltd v Lyford* [2004] FCA 1352 at [41] ff, *Australian Olive Holdings Pty Ltd v Huntley Management Ltd* [2009] FCA 1479 at [114]-[120], *Huntley Management Ltd v Timbercorp Securities Ltd* [2010] FCA 576 at [43]-[50], [65]-[66] and *Primary RE Limited v Great Southern Property Holdings Limited (recs & mgrs apptd) (in liq) & Ors* [2011] VSC 242 at [166] ff.

¹⁰⁹ Subparagraph (a)(iii) of the definition of 'managed investment scheme' in s 9.
¹¹⁰ s 601FM.

¹¹¹ s 601GC(1)(a).

¹¹² The related party provisions in Chapter 2E of the Corporations Act are applied, with modifications, to schemes by s 601LA. See Part 5C.7.

¹¹³ s 601NB.

¹¹⁴ Part 2G.4. In general, the RE and its associates are not entitled to vote their interest on a resolution if they have an interest in the resolution or matter other than as a scheme member: s 253E. There is a question as to the ambit of this provision.

faith and that the inspection will be made for a proper purpose.¹¹⁵ The court may also make ancillary orders, including restricting the use that a person who inspects the books may make of the information obtained.¹¹⁶

There is a statutory procedure for members seeking to withdraw their investment in a scheme (including the freezing of withdrawal rights for non-liquid schemes).¹¹⁷ There are also provisions dealing with certain contraventions by promoters or the RE.¹¹⁸

Restructuring

A reorganization or change of control of a company may be achieved through a scheme of arrangement under Part 5.1 of the Corporations Act. These provisions do not apply to schemes. Instead, changes of control or other reorganizations of schemes have tended to proceed through ‘trust scheme’ arrangements. There is no equivalent in these arrangements of the judicial and other procedural protections applicable to corporate schemes of arrangement under Part 5.1, though the proponents of a trust scheme may choose to seek judicial direction or advice on its implementation.

The CAMAC report *Members’ schemes of arrangement* (2009) recommended the extension of the Part 5.1 scheme of arrangement provisions to listed and unlisted schemes.¹¹⁹

The takeover and compulsory acquisition provisions in Chapters 6, 6A and 6B of the Corporations Act apply to the acquisition of interests in listed schemes.¹²⁰ Attempts to entrench an RE of a listed trust may amount to ‘unacceptable circumstances’ for the purposes of Chapter 6.¹²¹

¹¹⁵ s 247A.

¹¹⁶ s 247B.

¹¹⁷ Part 5C.6.

¹¹⁸ Part 5C.8.

¹¹⁹ Sections 7.2 and 7.6.2.

¹²⁰ s 604. See also ASIC Regulatory Guide 74 *Acquisitions approved by members and Takeovers Panel Guidance Note 15: Trust Scheme Mergers*.

¹²¹ *Re AMP Shopping Centre Trust (No 1)* (2003) 45 ACSR 496 at [66].

2.3 The RE transacting as operator of a scheme

2.3.1 Overview

A scheme is not a separate legal entity and therefore cannot enter into agreements in its own right. In a pooled scheme, the RE acts as principal in operating the scheme and will be personally liable under each agreement it enters into in that capacity, except where the counterparty agrees otherwise. Scheme members will not be parties to those agreements. Likewise, in common enterprise schemes, the RE will transact as principal in operating the scheme (and be personally liable, unless the counterparty agrees otherwise), except where the members themselves enter into agreements as principals, using the RE as their agent for this purpose. To assist the RE in acting as agent for scheme members, it has been the practice with some common enterprise schemes for the application form signed by any person seeking to become a scheme member to contain a grant of a power of attorney to the RE.¹²²

A counterparty to an agreement where the RE acts as principal may agree to limit its rights of recovery against the RE to the amount for which the RE can be indemnified from the property of the scheme (limited recourse rights), thereby excluding rights of recovery against the personal assets of the RE. It is common for limited recourse rights clauses to be incorporated in agreements drawn up by an RE as operator of a scheme.¹²³

2.3.2 Indemnity rights of the RE

An RE, as operator of a scheme, and as the principal to agreements into which it enters in that capacity, has rights to be indemnified out of the property of that scheme, by application of trust law principles, for:

- its costs and remuneration in operating the scheme

¹²² See, for instance, *Re Elders Forestry Management Ltd* [2012] VSC 287 at [15].

¹²³ In some schemes, the RE may contract out its management role to another party, with agreements involving outside parties also containing limited recourse rights to protect the manager against personal liability.

- the obligations or liabilities that it personally incurs under those agreements.¹²⁴

It has long been recognised that a trustee can resort to the property of the trust to discharge a liability that it has properly incurred as trustee of that trust.¹²⁵ A trustee can:

- apply the trust property directly in discharging the liability,¹²⁶ or
- itself discharge the liability and then exercise a right to be reimbursed from the property of the trust for the costs it has incurred.¹²⁷

These trust law principles are summarised in one case as follows:

The trustee is entitled to be indemnified out of the trust assets in respect of liabilities which it incurs in the course of administering the trust, but is personally liable to creditors in respect of such liabilities unless it has contracted with a creditor to limit the creditor's recourse against it. If the trustee has discharged the liability out of his individual property, he is entitled to reimbursement from the trust fund. If he has not discharged it, he is entitled to be exonerated from the trust fund for the liabilities properly incurred in the administration of the trust. He cannot be compelled to surrender the trust property to the beneficiaries until his claim has been satisfied.¹²⁸

These indemnification rights of a trustee are available to an RE of a scheme only if:

- they are specified in the constitution of the scheme, and

¹²⁴ The applicable trust law principles are summarised in *JA Pty Ltd v Jonco Holdings Pty Ltd* [2000] NSWSC 147 at [50].

¹²⁵ *Worrall v Harford* (1802) 8 Ves Jun 4.

¹²⁶ In trust law this is described as the 'right of exoneration'.

¹²⁷ In trust law this is known as the 'right of recoupment' or the 'right of reimbursement'.

¹²⁸ *Stacks Managed Investments Ltd* [2005] NSWSC 753 at [43]. See also *CPT Custodian Pty Ltd v Commissioner of State Revenue* [2005] HCA 53, which held that the trust fund available to the beneficiaries of a trust could not be identified and quantified until the trustee's superior indemnity rights concerning those funds had been quantified and satisfied.

- the RE has properly performed its duties.¹²⁹

The RE will not have an indemnity claim against the property of the scheme where the RE has acted beyond power (including outside the terms of the scheme constitution) or otherwise improperly.¹³⁰ This statutory limitation on an RE's right of indemnity is reinforced by the general trust law limitation whereby a trustee's right of indemnity is subject to, and diminished by, any lawful claim by beneficiaries against the trustee in connection with breaches by the trustee, for instance misappropriation, or neglect, of scheme property.¹³¹

Any attempt in a scheme constitution or otherwise to deny a lawful indemnity right of the RE, otherwise given in the constitution, because the RE has gone into external administration, is void.¹³²

2.3.3 Rights of counterparties

A scheme is not a legal entity¹³³ and therefore cannot enter into agreements in its own right. Instead, the RE, as scheme operator, transacts as principal to all agreements into which it enters in that capacity, except where it specifically acts as agent for another party.¹³⁴

¹²⁹ s 601GA(2).

¹³⁰ s 601GA(2). This is based on trust law principles. See, for instance, *General Credits Ltd v Tawilla Pty Ltd* [1984] 1 Qd R 388 at 389-390, *RWG Management Ltd v Commissioner for Corporate Affairs* [1985] VR 385. See also RI Barrett, 'Insolvency of registered managed investment schemes', Paper delivered at the Conference of the Banking and Financial Services Law Association, Queenstown, July 2008, pp 5-7.

¹³¹ This 'clear accounts' rule and its consequences are discussed by N D'Angelo, 'The unsecured creditor's perilous path to a trust's assets: Is a safer, more direct US-style route available?' (2010) 84 *Australian Law Journal* 833 at 841 ff.

¹³² s 601FH. This adopts a recommendation of the ALRC/CASAC report (vol 1, para 8.8), endorsing a recommendation of the ALRC's *General Insolvency Inquiry* (ALRC 45) (the Harmer Report) vol 1, para 251; vol 2, s T3 (see also vol 1, para 271 of the Harmer Report for the application of this provision to the administrator and deed administrator).

¹³³ *Capelli v Shepard* [2010] VSCA 2 at [92].

¹³⁴ Where an RE enters into an agreement, consideration may need to be given to the terms of the agreement and other surrounding circumstances to determine whether the RE has acted as operator of a particular scheme. This is based on trust law principles, as set out in *Re Interwest Hotels Pty Ltd (in liq)* (1993) 12 ACSR 78.

Where RE provides security

A counterparty can enforce any security lawfully granted to it by an RE when acting, as principal or agent, in any capacity. For instance, the RE may provide particular scheme property as security for an external financier that is funding the scheme under a limited recourse rights arrangement.

Where RE acts as agent

Where an RE has entered into agreements solely as the agent for members of a scheme (as in some common enterprise schemes), counterparties will have remedies against those members only, provided that the RE has acted within its agency powers. These agreements may include provisions that terminate or otherwise affect rights on the happening of certain events, such as the scheme being wound up.¹³⁵ If an RE has acted ostensibly as an agent for scheme members, but beyond its agency powers, counterparties may have remedies against the RE only (applying relevant agency law principles).

Where RE acts as principal

Where the RE enters into an agreement as principal in operating a particular scheme, then, by application of general law principles, and subject to the counterparty having agreed to limited recourse rights only, the counterparty will have:

- a direct right against the personal assets of the RE (which include funds already received by the RE through the earlier exercise of its indemnity rights against the property of that scheme, or any other scheme that it operates), and
- an indirect subrogation remedy in relation to any unexercised indemnity rights of the RE against the property of that scheme.¹³⁶ Counterparties cannot make a direct claim on the

¹³⁵ See, for instance, *Re Elders Forestry Management Ltd* [2012] VSC 287 at [13].

¹³⁶ This is based on trust law principles, as summarised by the High Court in *Octavo Investments Pty Ltd v Knight* [1979] HCA 61 at [13] ff.

property of that scheme, which is held in trust by the RE for scheme members.¹³⁷

A counterparty with limited recourse rights has no rights against the personal assets of the RE. Limited recourse rights are similar to the indirect subrogation remedy in that both are limited to the lawful indemnity claims that the RE can make against available scheme property.

As previously indicated (Section 2.3.2), an RE may lose its right of indemnity in various circumstances. In consequence, the improper conduct of the RE may affect the capacity of counterparties with limited recourse rights to obtain recovery from scheme property, or for other counterparties to exercise their subrogation remedies in relation to scheme property.

One judge, speaking extra-judicially, has summed up the position in the context of trusts:

The trustee's [indemnity] rights ... are fragile things. And their fragility may rebound upon creditors. The beneficiaries' interest in trust property will not be postponed to a beneficial interest of the trustee unless the trustee's interest exists. If the trustee's interest does not exist, the trust property is shielded from the claims of the trustee's creditors.¹³⁸

Counterparties may also be disentitled from claiming against scheme property under the subrogation remedy by their own behaviour. One commentator¹³⁹ has summed up the position as follows:

Some in commerce, including lawyers, refer to a 'right' of subrogation. In fact, it is not a right at all, or even a cause of action, but rather an equitable remedy acting on the

¹³⁷ s 601FC(2). In *Octavo Investments Pty Ltd v Knight* [1979] HCA 61 at [30], the High Court indicated that trust property itself cannot be taken in execution by the creditors of the trustee.

¹³⁸ RI Barrett (now a judge of the NSW Court of Appeal), 'Insolvency of registered managed investment schemes', Paper delivered at the Conference of the Banking and Financial Services Law Association, Queenstown, July 2008, p 5.

¹³⁹ N D'Angelo, 'The unsecured creditor's perilous path to a trust's assets: Is a safer, more direct US-style route available?' (2010) 84 *Australian Law Journal* 833 at 843.

conscience of the trustee.¹⁴⁰ Being a creature of equity, it is discretionary and subject to all the usual rules for engaging equitable remedies. This means that an enforcing unsecured trust creditor may be denied subrogation by application of disentitling equitable defences such as unconscionability, laches, acquiescence, waiver, estoppel, clean hands, or who comes to equity must do equity. Potentially, parties with something to gain (for example, the beneficiaries or even competing trust creditors) could manoeuvre to deny an unsecured trust creditor its claim to subrogation and, therefore access to the trust assets, by seeking to demonstrate disentitling behaviour on the part of the creditor, leaving it to its rights against the trustee personally and a share out of the trustee's personal assets (if any) in liquidation.

Where an RE goes into external administration, uncertainty remains about who can claim against any property recovered by its external administrator through exercise of any previously unexercised indemnity rights of the RE. One line of trust law authority is that, in the insolvency of a trustee, funds recovered under the trustee's right of indemnity out of property of any trust should be available for all creditors of that trustee.¹⁴¹ Another line of authority is that, in the first instance, those funds should be available only for those creditors who have dealt with the trustee as trustee of that particular trust.¹⁴²

2.3.4 Position of scheme members

Scheme constitutions usually exempt scheme members from any obligation to indemnify the RE for costs and liabilities that it has

¹⁴⁰ *Lerinda Pty Ltd v Laertes Investments Pty Ltd* (2009) 74 ACSR 65; [2009] QSC 251; see also *Bofinger v Kingsway Group Ltd* (2009) 239 CLR 269 at [6].

¹⁴¹ *Re Enhill Pty Ltd* [1983] 1 VR 561.

¹⁴² *Re Suco Gold Pty Ltd* (1983) 33 SASR 99. The Harmer Report (vol 1, para 262) summarised the position reflected in *Re Suco Gold* as follows:

Equitable principles require that a [trustee] company's own property and trust property, or property of two or more trusts, and the respective sets of creditors be kept separate and that each group of creditors be entitled to a distribution of the funds derived from the property in which they could claim an interest.

See also *Re ADM Franchise Pty Ltd* (1983) 7 ACLR 987, which is consistent with the *Suco Gold* approach. Various commentators also support the *Suco Gold* approach: R Baxt, 'Trusts and Creditors Rights' (1982) 11 ATR 3, 9; BH McPherson, 'The Insolvent Trading Trust' in PD Finn (ed), *Essays in Equity* (Law Book Co, Sydney, 1985), 142; and HAJ Ford, 'Trading Trusts and Creditors' Rights' (1981) 13 *Melbourne University Law Review* 1.

incurred in operating the scheme. If not, the RE may have a right of indemnity against those members for those amounts.¹⁴³

2.4 External controls

The RE of a listed scheme is under a continuing obligation to notify the market of any material price-sensitive information concerning the scheme that is known to the RE but is not generally available.¹⁴⁴

ASIC has a range of powers under Chapter 5C, including to make various exemption and modification orders,¹⁴⁵ to undertake surveillance checks of REs,¹⁴⁶ to require modification of a compliance plan,¹⁴⁷ and to apply to the court to have a TRE appointed¹⁴⁸ or to have a scheme wound up.¹⁴⁹

ASIC also has a range of investigative and other powers, including those pursuant to the licensing regime for the RE¹⁵⁰ and its general information-gathering powers under the ASIC Act.¹⁵¹

ASIC provides regulatory guidance on various aspects of the operation of schemes.¹⁵² ASIC has also commenced a series of reviews across various schemes sectors, to examine whether the compliance behaviour of REs meets both their legal obligations and good industry practice.¹⁵³

¹⁴³ *Fitzwood Pty Ltd v Unique Goal Pty Ltd* [2002] FCAFC 285 at [135]-[138]. See further the CASAC report *Liability of Members of Managed Investment Schemes* (March 2000), available under 'Publications' on the CAMAC website www.camac.gov.au

¹⁴⁴ Chapter 6CA *Continuous disclosure*. Specific reference to the obligation of the RE is found in s 674(3).

¹⁴⁵ Part 5C.11.

¹⁴⁶ s 601FF.

¹⁴⁷ s 601HE(2).

¹⁴⁸ s 601FN.

¹⁴⁹ s 601ND. See also s 601NF.

¹⁵⁰ See, for instance, ss 912C-912E.

¹⁵¹ Part 3 of the ASIC Act.

¹⁵² See, for instance, ASIC Regulatory Guides 132-136 and the best practice unit pricing guide (RG 94).

¹⁵³ See ASIC Media Release 12-168MR (July 2012), which outlines the results of an ASIC review of the unlisted property scheme sector.

2.5 Voluntary administration of a scheme

The ALRC/CASAC report recommended that a voluntary administration (VA) framework for schemes be introduced, similar to that for companies under Part 5.3A.¹⁵⁴ A scheme VA procedure may provide an opportunity to restructure a financially stressed, but potentially viable, scheme, or otherwise provide a better return for scheme creditors than if the scheme was immediately wound up.

Those recommendations were not adopted. Neither the second reading speech for the *Managed Investments Bill 1997* (Cth), which provided for the introduction of Chapter 5C into the Corporations Act, nor the Explanatory Memorandum to that Bill, explained this omission.

2.6 Winding up a scheme

The procedures for the winding up of a scheme that were introduced in 1998 primarily envisage the winding up of solvent schemes, with the RE conducting the winding up, though the court has a power to order a winding up on the ‘just and equitable’ ground and to ‘appoint a person to take responsibility’ for the liquidation of a scheme if the court ‘thinks it necessary to do so’.¹⁵⁵

Historically, little consideration was given to the winding up procedures for insolvent schemes, particularly when they were more in the nature of pooled schemes involving securities or other investment portfolios, with no significant creditor involvement. Pooled schemes of this nature were more likely to lose value and be wound up for that reason, rather than be unable to meet the claims of creditors as they became due and payable.

However, the approach in Australia over more recent years, driven in part by taxation considerations and the growth of superannuation funds under management, has been to expand the role of schemes, with some of them becoming significant commercial enterprises in their own right, with external financing or other creditors. There is no detailed procedure in the current law for the winding up of these types of schemes if they become insolvent.

¹⁵⁴ vol 1 at Section 8.13 and vol 2 Pt 5.3B.

¹⁵⁵ Part 5C.9.

3 MIS as a separate legal entity

This chapter sets out the elements of an alternative approach to the legal framework for schemes, based on making the MIS (as a separate legal entity), rather than the RE, the principal to agreements forming part of the scheme and the holder of legal title to scheme property. This approach would simplify the regulatory structure for schemes and overcome some key problems that have arisen in practice.

3.1 Difficulties under the current legal framework

Currently, the RE, as operator of a scheme:

- transacts as principal in agreements that form part of the scheme. In some cases, however, the RE may transact as agent for scheme members
- holds legal title to all scheme property. That property is held on trust for scheme members.

These arrangements can create legal complexities and problems in practice, as set out below.

Personal liability of the RE

The task of finding a suitable TRE or a new RE for a particular scheme can be made more difficult by the current legislative regime under which the obligations and liabilities that an RE has incurred as principal in operating a scheme (as well as the rights that it has acquired) automatically transfer to any TRE or replacement RE.¹⁵⁶ This regime, while intended to protect counterparties to these agreements, whose rights should not be affected by a change of RE, can discourage suitable entities from agreeing to undertake the role of TRE or new RE.

¹⁵⁶ s 601FS.

An RE can avoid incurring personal obligations and liabilities when entering into these agreements by the counterparty agreeing to have only limited recourse rights. However, an intending TRE or new RE, as part of its due diligence, would still need to determine, for all agreements that were entered into by a former RE as operator of the scheme, and that are still on foot, which of them did/did not give the counterparty only limited recourse rights.

No direct claim against scheme property

A counterparty to an agreement with an RE, with or without limited recourse rights, cannot claim directly against the property of the scheme. The counterparty has a subrogation remedy in relation to the indemnity rights of the RE over scheme property. However, those indemnity rights, and therefore the subrogation remedy, may be lost by the improper conduct of the RE.¹⁵⁷

External administration

Where a scheme or its RE suffers financial stress, the process of attempting their rehabilitation or orderly winding up can be complicated by the entangling of the affairs of the scheme and of the RE.¹⁵⁸

The CAMAC discussion paper highlighted some of these structural difficulties with schemes and included various reform proposals for further consideration. These proposals were put forward in the context of the current legal framework for schemes and prior to the development of the Separate Legal Entity Proposal (SLE Proposal).

3.2 Outline of the SLE Proposal

CAMAC has developed the SLE Proposal as an alternative to reforms that would have sought to improve, but nevertheless maintain, the current legal framework for schemes.¹⁵⁹ CAMAC considers that the SLE Proposal would resolve many of the problems that have been encountered with schemes under that framework.

¹⁵⁷ See Section 2.3.2 of this report.

¹⁵⁸ See Section 6.3 of this report.

¹⁵⁹ CAMAC acknowledges the role of the Alternative Proposal put forward in the submission by Freehills in the development of the SLE Proposal.

Under the SLE Proposal, each scheme, whether a pooled or common enterprise scheme, would involve a registered MIS, to be given the status of a separate legal entity, distinct from its RE or the scheme members, for limited purposes:

- *to own scheme property.* The MIS would hold legal title to all scheme property. In doing so, the MIS would not be acting as a trustee for scheme members (who instead would hold residual rights to scheme property, similar to shareholders, in the event of the scheme being wound up). This would represent a change from the current legal position, whereby the RE holds legal title to scheme property, on trust for scheme members. This change would ensure that scheme property is fully separate from the personal assets of the RE or the property of any other scheme operated by the RE¹⁶⁰
- *to enter into agreements.* In operating a scheme, the RE would enter into agreements as agent of the MIS, which would be the principal. This would represent a change from the current legal position whereby the RE, in operating a scheme, enters into agreements as principal¹⁶¹
- *to sue or be sued.* The MIS, acting through the RE as its agent, could sue or be sued in its own right. Counterparties to agreements entered into by the MIS through the disclosed agency of the RE would have direct rights against all scheme property, legal title to which is held by the MIS.¹⁶² This would represent a change from the current legal position whereby counterparties have only an indirect subrogation remedy against scheme property.¹⁶³ The MIS, acting through the RE as its agent, could take action in its own name to enforce agreements into which it entered as principal.

¹⁶⁰ Vesting legal title to scheme property in the MIS would not interfere with any obligation that ASIC may impose concerning the use of a custodian in some circumstances: ASIC Regulatory Guide 133 *Managed investments: Scheme property arrangements*.

¹⁶¹ The only exception is where, under the terms of some common enterprise schemes, the RE acts as agent for scheme members, who are the principals to these agreements.

¹⁶² The SLE Proposal would not negate the use of a custodian of scheme property, if appropriate.

¹⁶³ See Section 2.3.3.

An MIS would not have any directors, officers, members or employees. It would itself have no directing mind or will, or capacity to act in its own right. It would act exclusively through the RE, as its disclosed agent.

The RE would still be required to hold an AFSL. It would have two roles:

- *manager of the scheme* for the purpose of operating it on a day-to-day basis
- *agent for the MIS* for the purpose of binding the MIS, as principal, in agreements entered into by the RE in its managerial role.

This separation of the affairs of a scheme from the personal affairs of its RE through this agency arrangement would simplify the operation of schemes in various ways:

- *sole-function or multi-function REs*. Under the SLE Proposal, it would be irrelevant from a regulatory perspective whether a scheme was operated by a sole-function or by a multi-function RE. The RE would only act as agent in operating a scheme, and in that capacity would not incur rights, obligations and liabilities on its own behalf. Accordingly, there would be no need to identify the various rights, obligations and liabilities that a multi-function RE may incur and determine which apply to which schemes. This separation process is essential for multi-function REs under the current legal framework in those instances where the RE incurs personal liability when operating a number of schemes
- *solvency of the RE*. Under the SLE Proposal, the state of solvency of the RE would be irrelevant to the solvency of a scheme (though it would be necessary to replace an insolvent RE of a solvent scheme). The rights of recovery of counterparties against the scheme would be limited to scheme property, held by the MIS. The external administration of a scheme would be independent of any external administration of its RE (though in some instances, from a practical point of view, they could be run

in tandem¹⁶⁴). By contrast, under the current legal framework, counterparties to agreements with the RE as operator of the scheme can recover against the personal assets of the RE, except where they have only limited recourse rights. This financial involvement of the RE can complicate the external administration process of a scheme.

The SLE Proposal would not interfere with arrangements under some common enterprise schemes whereby the RE is given the power to act as agent for the scheme members. In those cases, counterparties would have remedies directly against the members, as principals.

Under the SLE Proposal, scheme members would retain all existing procedural rights, such as to have the scheme administered according to the scheme constitution and any other rights conferred by scheme documents. However, unlike the current legal position, they would not hold any beneficial interest in the scheme property. Rather, they would have residual rights to any remaining scheme property on the winding up of the scheme, comparable to residual shareholder rights.

3.3 Other details of the SLE Proposal

The SLE Proposal would involve various other elements:

- *disclosed principal*: an RE could enter into an agreement binding the MIS of a scheme operated by the RE only if the RE identifies that it is acting as agent for that MIS. Where the RE does not make this disclosure, it would be personally liable as a principal under the agreement, with no indemnity rights against scheme property for this agreement, and with the counterparty having remedies only against the RE

¹⁶⁴ An example would be an insolvent scheme operated by a sole-function RE. The insolvency of the scheme may also lead to the insolvency of the RE, given that the only function of a sole-function RE is to operate the one scheme. The affairs of the RE and of the scheme may therefore sufficiently coincide that the practical course would be to run the external administration processes in tandem, which may include by the same external administrator.

- *indoor management rule*: to protect counterparties, there would be an indoor management rule similar to that for companies.¹⁶⁵ Under this rule, a counterparty would be entitled to assume that an RE that discloses that it is acting as agent for a particular MIS is acting within its agency powers and is otherwise complying with the requirements of the scheme, unless the counterparty knew or suspected otherwise¹⁶⁶
- *compliance plan*: the current requirement for a compliance plan¹⁶⁷ would still apply, given that the RE would retain its managerial role, but with adjustments to reflect that scheme property is held by the MIS (not the RE) and that the MIS (not the RE) is the principal to agreements forming part of the scheme
- *accounting obligations*: the RE would continue to have the obligation to ensure that the books and records of the scheme are maintained¹⁶⁸
- *managerial duties*: the RE would operate the scheme as the day-to-day manager, with the RE and its officers and employees having duties comparable to those set out in the current legislation.¹⁶⁹ However, these managerial duties would be owed to the MIS, not to scheme members (as under the current legal framework for schemes)
- *recovery against the RE*: where an RE acts in breach of its managerial duties or outside its agency powers, the MIS would have a right of action against the RE, and each of its directors,¹⁷⁰ for maladministration. Given that the MIS itself has no controlling mind, other than through the RE, other parties should have the right to commence an action against the RE for breach of duty, namely:
 - a TRE

¹⁶⁵ ss 128-129.

¹⁶⁶ cf s 128(4).

¹⁶⁷ Part 5C.4.

¹⁶⁸ s 286.

¹⁶⁹ ss 601FB-601FE.

¹⁷⁰ For instance, in some circumstances rights of recovery might be available against the directors of the RE under s 197.

- a replacement RE
- an administrator or liquidator of the scheme
- ASIC, or
- a scheme member.

Scheme members should be entitled to act through a derivative procedure for schemes, comparable to Part 2F.1A of the Corporations Act that applies with companies.

3.4 Rights of counterparties

As earlier indicated,¹⁷¹ under the current legal framework, a counterparty to an agreement entered into with the RE as operator of a scheme:

- has direct rights against the personal assets of the RE (except where the counterparty has agreed to only limited recourse rights)
- has an indirect subrogation remedy relating to scheme property held by the RE to the extent that the RE has lawful indemnity rights against that property (relevant also to limited recourse rights).

The only exception is where, as in some common enterprise schemes, the RE acts as agent for scheme members. In those instances, only the involved scheme members would be liable, as principals, under the agreements (though the RE may agree to assume some form of personal liability).

Under the SLE Proposal, where an RE lawfully acts as agent for the MIS, or the indoor management rule applies, a counterparty:

- would not have any rights against the personal assets of the RE (as the RE would not be a principal to those agreements). In this respect, the rights of the counterparty would be similar in effect to limited recourse rights, but

¹⁷¹ Section 2.3.3.

- unlike limited recourse rights, the counterparty would have direct rights against scheme property, held by the MIS. Those rights would not depend on the indemnity rights of the RE against scheme property (which rights may be lost through the improper conduct of the RE).

Where the RE was acting beyond its agency powers, and the indoor management rule did not apply, the counterparty would have remedies only against the RE.

This report elsewhere recommends that scheme members be given statutory limited liability.¹⁷² This would ensure that, where the RE enters into agreements as agent for the MIS, counterparties cannot seek remedies against scheme members under those agreements.

The SLE Proposal would not prohibit counterparties from making additional private arrangements with the RE to protect their interests. In those circumstances, however, privity of contract principles should apply, as the RE would be acting outside its role as agent of the MIS. For instance, a counterparty may require an RE to provide some form of financial accommodation as a condition of the counterparty entering into an agreement with the RE as agent for the MIS. The counterparty would have a direct right of action against the RE to enforce any such personal undertaking by the RE. However, under the SLE Proposal, that personal undertaking of an RE would not transfer to a TRE or new RE. In that respect, the intention is that s 601FS be redundant. A counterparty could take these matters into account in deciding whether to seek some personal undertaking from the RE, and the nature of its terms.

3.5 Indemnity rights of the RE

Under the current legal framework, the RE, as operator of a scheme, has indemnity rights against the scheme property for the obligations and liabilities that it incurs in entering into agreements as principal, as well as for its costs and remuneration.¹⁷³

Under the SLE Proposal, the RE, being the agent for the MIS, would no longer incur personal liability for agreements into which it enters

¹⁷² Section 8.4.3.

¹⁷³ See Section 2.3.2 of this report.

as operator of the scheme. Its indemnity rights against scheme property would therefore be limited to its costs and remuneration for acting as manager and agent. The prerequisites that apply under the current legal framework to the exercise by an RE of its indemnity rights (namely that the rights must be specified in the scheme constitution and that the RE has properly performed its duties¹⁷⁴) should also apply under the SLE Proposal.

As the MIS would not have a controlling mind in its own right, any member of the compliance committee (if established¹⁷⁵), or a scheme member, should have the right to challenge in court the legality of any recovery by the RE from scheme property under an indemnity right claim.

3.6 Insolvent trading

As the day-to-day manager of a scheme, the RE would be best placed to monitor the scheme's ongoing financial position and determine whether it is at risk of insolvency. Elsewhere in this report, a scheme is defined as insolvent (under both the current legal framework and the SLE Proposal) if there is insufficient scheme property to satisfy all claims that lawfully could be made against that property, as and when the claims became due and payable.¹⁷⁶

To promote responsible behaviour by the RE and its directors in operating the scheme, and to provide better protection to counterparties, the RE and its directors should be personally liable if, at the time that the RE enters into an agreement as disclosed agent for the MIS, the scheme is insolvent. This would be comparable to the regime that applies to company directors.¹⁷⁷

¹⁷⁴ s 601GA(2). See further Section 2.3.2 of this report.

¹⁷⁵ Subsection 601JA(1) sets out the circumstances in which a compliance committee must be established.

¹⁷⁶ See also Section 6.3.2 of this report.

¹⁷⁷ See ss 588G and 588H, which set out the duty of company directors to prevent insolvent trading by the company and the applicable defences. The role of the insolvent trading provisions in the corporate context was described by the New South Wales Supreme Court in *Woodgate v Davis* [2002] NSWSC 616 at [36]:

The approach under the SLE Proposal compares with the current legal position for schemes whereby the directors of an RE are personally liable if the RE is insolvent when it enters into any agreement under which the RE incurs personal debts, including as operator of a scheme.¹⁷⁸

The extension of liability for insolvent trading to the RE (in addition to its directors) under the SLE Proposal is in recognition that the RE may be solvent and that better recovery may be achieved than applying the insolvent trading provisions only to the directors of the RE.¹⁷⁹

Applying the insolvent trading provisions in this context would require a TRE or new RE to be cautious about entering into agreements as agent for the MIS until it sufficiently understood the overall financial position of the scheme it had undertaken to operate. However, a TRE or new RE would not be personally liable for insolvent trading transactions entered into by a former RE.

3.7 Replacing the RE

Under the current law (s 601FS), a TRE or a new RE is subject to the obligations and liabilities (as well as having the rights) of the former RE as operator of the scheme.¹⁸⁰

The intention is that the SLE Proposal negate the need for this requirement. The MIS, not the RE, would incur the rights, obligations or liabilities under agreements entered into by the RE within its agency power or under agreements covered by the indoor management rule presumption. In other circumstances (including where the RE undertook some form of personal liability), only the RE that has entered into an agreement would be personally liable,

Section 588G and related provisions serve an important social purpose. They are intended to engender in directors of companies experiencing financial stress a proper sense of attentiveness and responsible conduct directed towards the avoidance of any increase in the company's debt burden. The provisions are based on a concern for the welfare of creditors exposed to the operation of the principle of limited liability at a time when the prospect of that principle resulting in loss to creditors has become real.

¹⁷⁸ ss 588G and 588H.

¹⁷⁹ cf s 588V where a holding company may be liable for the insolvent trading of a subsidiary. Recovery orders against directors of companies that engaged in insolvent trading can be made under Part 5.7B Div 4.

¹⁸⁰ See further Section 2.2.2 under the heading *Replacement of the RE*.

with the counterparty having remedies only against that RE, not any subsequent TRE or new RE.

The SLE Proposal would simplify the process of replacing the RE. It overcomes the problems raised in practice where an RE fails, or the scheme members wish to replace the RE, but no suitable entity is immediately willing either to be appointed by the court as a TRE, or to agree to become a new RE, because of the effect of s 601FS.

3.8 Taxation matters

The tax treatment of schemes is an important factor in their use as a collective investment vehicle. CAMAC intends that the SLE Proposal be revenue-neutral, by ensuring that treating an MIS as a separate legal entity (for certain purposes) does not change the current taxation treatment of a scheme, to which 'pass through' provisions apply.

If the SLE Proposal is applied to some or all existing schemes, it would also be necessary to ensure that the transfer of legal title to scheme property from the RE to the MIS is treated as a form of tax free roll-over of property, exempt from stamp duty.

3.9 CAMAC position

CAMAC sees the SLE Proposal as a means to resolve many of the legal problems that have arisen with the operation of schemes under the current legal framework, and which are highlighted when schemes suffer financial stress. The SLE Proposal also creates greater conformity between schemes and companies in an environment where many schemes are involved in major enterprises similar to companies. Schemes represent a significant proportion of the investment or enterprise market and, like companies, should have a consistent, well understood regulatory structure that both governs their operations and the dealings of those who invest in or deal with them, and can adequately respond to the various situations that can arise in practice.

CAMAC has closely considered the various ways in which the regulation of schemes could be adjusted for the SLE Proposal. They include:

- apply the SLE Proposal to all existing and new common enterprise schemes (thereby exempting all pooled schemes)
- apply the SLE Proposal to all new common enterprise schemes (thereby exempting all pooled schemes and existing common enterprise schemes)
- apply the SLE Proposal to all new schemes (thereby exempting all existing pooled schemes and common enterprise schemes)
- apply the SLE Proposal to all existing and new schemes (thereby having no exemptions).

Further variants on the first three options could be to exempt schemes for no more than a stipulated transitional period or permit each exempt scheme to choose whether to be regulated under the SLE Proposal (for instance, through a statement in the scheme constitution).

While recognising that arguments could be put forward for each option, CAMAC's preferred position is that the SLE Proposal be adopted for both common enterprise schemes and pooled schemes, and that there be no exemption for existing schemes. It is important to avoid any form of multi-tier regulatory system (either between pooled and common enterprise schemes or between existing and new schemes) and, in the longer term, to ensure a consistent approach to all scheme structures. Any option that exempts particular types of schemes from the SLE Proposal, or permits exempt schemes to decide whether to be regulated under the SLE Proposal, would result in a significantly more complex regulatory structure. It would also create difficulties for outside parties in understanding their legal position when dealing with different types of schemes and raise the likelihood of the SLE Proposal having minimal or partial application for a considerable time.

The Committee recognises that its preferred approach would involve material conversion costs, to be borne by pooled schemes as well as common enterprise schemes. It would affect existing arrangements with, and the rights of, external parties, such as scheme financiers. It

would also require amendments to the tax laws, both to exempt the transfer of title to assets from the RE to the MIS from stamp duty and other tax consequences, and to ensure the ongoing ‘flow through’ tax treatment of schemes once they are converted to the SLE structure.

These factors may justify a relatively long transition period to the new regulatory structure. However, some of the changes that would be required to implement the SLE Proposal, such as identifying the property of each scheme for the purpose of its being held by the MIS, are seen by CAMAC as necessary for all schemes, whether or not the SLE Proposal is adopted.¹⁸¹

CAMAC is also aware that adoption of the SLE Proposal, while resolving many issues, would involve a significant change to the operation of schemes. To avoid an ‘all-or-nothing’ set of recommendations, subsequent chapters of this report set out the CAMAC position on each issue under, and in the absence of, the SLE Proposal. It is also noted where the SLE Proposal does not deal with (which includes does not affect) a matter under consideration.

¹⁸¹ See Section 4.4.3 of this report.

4 Proposed key legislative reforms

This chapter considers the need for legislative reforms concerning the identification and recording of the affairs and property of each scheme, as well as the rights of parties dealing with the scheme.

4.1 Current position

4.1.1 Problems in practice

Much of the complexity, disputation, delay and costs that have surrounded the external administration of some common enterprise schemes in recent years can be traced to earlier failure by REs to ensure:

- adequate separation and recording of the affairs of each of the schemes that they operate
- clear identification of scheme property and its separation from the proprietary interests of scheme members utilised in the schemes.

Legal complexity has also arisen where investment arrangements involve REs operating a number of schemes, which, in turn, may form part of a more complex scheme/corporate ‘stapled’ arrangement. The more complex the structure of these arrangements, the greater the risk of entanglement of the affairs of different schemes and of confusion over the relative rights of scheme members and external parties.

The difficulties that can arise in disentangling the affairs of different schemes, and identifying the various property interests and remedial rights involved, point to the need to ensure, from the time each scheme is established, that its affairs, as well as its property, can be clearly identified and that persons dealing with an RE as operator of a particular scheme can have a clear understanding of their legal position. Recent experience points to the shortcoming of waiting until schemes encounter financial stress before attempting to deal with these issues.

4.1.2 Sole-function and multi-function REs

The current legislative structure for schemes in Chapter 5C of the Corporations Act tends to focus on a single scheme operated by its RE, with some recognition that an RE may operate more than one scheme. The legislation is drafted principally from the perspective of the scheme, with the provisions relating to the role of its RE focusing primarily on the RE's conduct of that scheme.

An RE may be incorporated solely for the purpose of operating a single scheme, with all of its dealings attributable to its operation of that scheme (sole-function RE). However, it is common for an RE to operate a number of schemes, and possibly also in its own right conduct other activities that have no relationship to the operation of any of its schemes (multi-function RE). A multi-function RE may therefore, over time, enter into a series of agreements, including as operator of different schemes.

The majority of registered REs are multi-function REs, with approximately:

- 39% of REs operating one scheme
- 32% of REs operating more than one, but less than 5, schemes
- 26% of REs operating 5 or more, but fewer than 50, schemes
- 3% of REs operating 50 or more schemes.¹⁸²

A multi-function RE may be an 'internal' RE, set up for the purpose of operating a commercial venture that involves a number of related schemes. There are also multi-function 'external' REs, which operate schemes in a range of different enterprises. In addition, an RE may be part of an interconnected series of schemes (with different REs involved on behalf of one or more of the other schemes) that are all part of one operation or transaction ('interconnected schemes').

¹⁸² This statistical information was provided in July 2012 by ASIC, which also indicated that in July 2012 there were 487 REs, with some 3950 registered and operational schemes.

The legislation gives only limited recognition to these more complex types of RE arrangement.¹⁸³

4.2 Need for reform

Clear identification of the affairs and property of each scheme is essential to the effective day-to-day operation of a scheme, the transfer of the RE of a viable scheme, the restructuring of a financially stressed but potentially viable scheme, or the winding up of a scheme.

The potential for problems to arise in achieving this identification and separation can be heightened where, for instance, a multi-function RE is operating a common enterprise scheme. In that case:

- a clear separation will have to be drawn between the affairs and property of each scheme operated by the RE, and, in turn, how the affairs and property of each scheme are distinguished from any affairs or property of the RE through any other dealings
- the contractual and proprietary rights of scheme members, and how they intersect with the affairs and property of the scheme, will have to be identified.

4.2.1 Affairs and property of each scheme

An RE is obliged to keep separate the property of each scheme that it operates.¹⁸⁴ However, an RE has no statutory obligation to identify and record for which scheme (if any) it is acting when it enters into agreements as principal, though it may choose to do so.

The need for clear and accurate information on the affairs and property of each scheme can arise in various contexts. For instance, a multi-function RE may wish to transfer responsibility for operating one of its schemes to a new RE, or the members of a particular

¹⁸³ See, for instance, ss 601FC(1)(i), 601PB(1)(d)(ii) in relation to the duties of an RE and ss 601HA(1)(a) and 601HB in relation to compliance plans. See also the following footnote.

¹⁸⁴ Paragraph 601FC(1)(i) obliges an RE to ensure that scheme property for each scheme that it operates is 'clearly identified' and held separately from the property of any other scheme or the property of the RE.

scheme may seek to replace the RE. In either case, it is necessary to determine which of the accumulated rights, obligations and liabilities of the outgoing RE under the various agreements into which it may have entered attach to the affected scheme, given that, under the current legislative structure for schemes, those rights etc will transfer to the incoming RE of that scheme.¹⁸⁵ The legislation simply assumes that it is possible to identify the relevant documentation for each scheme, for the purpose of a deemed novation of the contracting parties.¹⁸⁶

4.2.2 The rights of creditors of each scheme

Parties who have entered into agreements with an RE will be concerned to know against what assets held by the RE they can claim, particularly when the RE goes into external administration.

Counterparties who have dealt with the RE as operator of a particular scheme have direct rights against the personal assets of the RE (unless they have agreed to having only limited recourse rights), in the same manner as other creditors of the RE.¹⁸⁷ However, they do not have a direct right against any property of that scheme, which is held on trust by the RE. Instead, they may seek subrogation to any unexercised indemnity rights of the RE against that property. These indemnity rights may be lost (and therefore the remedy of subrogation rendered nugatory) where the RE has acted beyond power or otherwise improperly.¹⁸⁸ The same limitation on recovery against scheme property applies to counterparties seeking to exercise limited recourse rights.

Uncertainty also remains about who can claim against property of a scheme recovered by any external administrator of an RE under any previously unexercised indemnity rights of the RE. Taking into account some conflicting trust law authority, one view is that all creditors of the RE can claim against that property, while another

¹⁸⁵ As observed in *Investa Properties Ltd* [2001] NSWSC 1089 at [11], where the RE of a scheme changes, the effect of s 601FS is 'to cause an incoming responsible entity to step into the shoes of its predecessor' concerning the rights, obligations and liabilities of the former RE in regard to that scheme.

¹⁸⁶ s 601FT.

¹⁸⁷ See further Section 2.3.1 of this report.

¹⁸⁸ See further Section 2.3.3 of this report.

view is that the right to claim is confined to those creditors who have dealt with the RE as operator of that scheme.¹⁸⁹

4.2.3 Reform proposals

The CAMAC discussion paper proposed a series of reform to:

- identify and record the affairs and property of each scheme that an RE operates
- place controls on the use of scheme property
- set out the rights of creditors of each scheme in relation to scheme property.

It was also intended that:

- the reform proposals would apply regardless of any contrary provision in a scheme constitution, and
- any general law principles that are inconsistent with the reform proposals would cease to apply in the context of schemes.

The reform proposals, set out in the following sections of this report, were originally formulated, and submissions were received, before the SLE Proposal was developed. Respondents therefore considered the proposals in the context of the current legal framework for schemes. The CAMAC position on each of the proposals includes an analysis of the implications of adopting the SLE Proposal.

4.3 Identification and recording of the affairs of each scheme

The affairs of a scheme can involve various types of agreements:

- those entered into by the RE, as operator of the scheme, with scheme members or external parties
- those entered into by the RE, as agent for one or more scheme members, with external parties

¹⁸⁹ See further Section 2.3.3 of this report.

- those entered into by scheme members themselves, pursuant to the operation of the scheme, with external parties.

4.3.1 Agreements with scheme members or external parties entered into by the RE itself as operator of a scheme

To operate a scheme, an RE may enter into a series of agreements with external parties, including for the provision of goods or services relevant to the scheme. The RE may also enter into agreements with scheme members including, with common enterprise schemes, agreements concerning proprietary or other rights or interests that the scheme member may have and how those rights or interests will be recognised or employed as part of the enterprise.

Reform proposal

Identification of agreements

Whenever an RE enters into an agreement as operator of a scheme, the RE must specify that this is the case and identify the scheme to the counterparty. The RE must include that information in any document constituting that agreement. Where the agreement involves more than one identified scheme, the RE must identify what part, or proportion, of the agreement is attributable to each scheme.

Recording of agreements

From the commencement of a scheme, the RE (including any replacement RE) must maintain an ongoing register of all relevant agreements for that scheme.

The agreements register must be divided into a ‘continuing agreements’ section and a ‘completed agreements’ section. Details of each agreement (and any material variations to that agreement) must be included in the former section, until such time as all rights, obligations and liabilities of any party under that agreement have been discharged, after which the details of the agreement must be transferred to the latter section.

The agreements register must be maintained throughout the life of a scheme. No agreement, whether or not still on foot, may be deleted from the register (except where recorded by mistake).

Issues

Should this reform proposal be enacted?

Should the agreements register be a definitive statement of all agreements entered into by an RE as operator of a particular scheme?

If yes:

- how could counterparties ensure that their agreements are included in the register? For instance, should they have a right of access to the register? Also, in what circumstances, if any, should they have a means to have the register amended?
- what remedies should affected parties have for failure to include an agreement in the register and against whom?

Explanatory note

This reform proposal sought to ensure that agreements entered into by an RE in operating a scheme, either with scheme members or external parties, are clearly identified and recorded.

The agreements register would provide a means to trace the way an RE has operated a scheme, including for the purpose of any external investigation of the conduct of the RE. It would also assist a potential TRE or replacement RE in undertaking due diligence on the affairs of a scheme, while also providing key information in the event of the scheme going into external administration.

The process of changing the RE of a scheme would also be assisted if a TRE or prospective new RE could rely on the register as a definitive record of all agreements involving any former RE, for the purpose of the transfer of rights, obligations and liabilities under s 601FS. The implications of an RE failing to record an agreement in an agreements register would also need to be taken into account in any move to introduce such a register.

Submissions

A number of submissions supported the principle of a register of all agreements entered into by the RE as operator of a scheme, either for

all schemes or at least for common enterprise schemes.¹⁹⁰ The register could assist scheme members, creditors, regulators, external administrators and the courts in determining the range of agreements forming part of a scheme, which can otherwise be difficult to identify, particularly with some common enterprise schemes.

Other submissions opposed this form of register.¹⁹¹ Some respondents considered that the current requirements under ss 286 (obligation to keep financial records), 601FC(1)(i) (obligation to identify and separately hold scheme property) and 601HA(1)(e) (compliance plan to ensure adequate records of the scheme's operations are kept) ensure sufficient recording and disclosure of relevant agreements, without the need for an additional agreements register.

Various respondents gave full or qualified support to the register of agreements, if introduced, being a definitive record of the agreements entered into by the RE as operator of the scheme.¹⁹² Some other respondents argued that, while this outcome would be beneficial to a TRE or a new RE, it could adversely affect the position of a counterparty where the RE has not properly recorded the agreement on the register.¹⁹³

Some respondents supported a right of inspection of an agreements register, if introduced, similar to the right of inspection of a scheme members' register (s 173).¹⁹⁴ Other respondents favoured restrictions on access to an agreements register, as it could contain commercially sensitive information.¹⁹⁵

CAMAC position

The CAMAC position is set out in Section 4.3.4.

¹⁹⁰ IPA, McCullough Robertson, Alan Jessup, Baker & McKenzie, ASIC, Property Council of Australia, AAR, Clarendon Lawyers, McMahon Clarke Legal.

¹⁹¹ Henry Davis York, Freehills, Ashurst Australia, Property Funds Australia, The Trust Company, Primary Securities Ltd, Financial Services Council.

¹⁹² IPA, Alan Jessup, Clarendon Lawyers (very qualified).

¹⁹³ Freehills, Henry Davis York, Baker & McKenzie, McCullough Robertson, Property Council of Australia, AAR, McMahon Clarke Legal.

¹⁹⁴ Alan Jessup, Clarendon Lawyers.

¹⁹⁵ AAR, Freehills.

4.3.2 Agreements with external parties entered into by the RE as agent for scheme members

Issues

Should an RE be required, from the commencement of an MIS, to establish a register of all arrangements entered into by the RE as agent of one or more scheme members?

Who should have access to that register and through what process?

Explanatory note

An RE, as agent for scheme members, may enter into agreements with external parties. This is more likely with some common enterprise schemes, which may involve scheme members being more directly involved in the enterprise than under pooled schemes, where the scheme members are passive investors. For this purpose, an RE may be given a power of attorney to act for a member pursuant to the terms of the scheme.¹⁹⁶

It would assist the process of identifying the full scope of agreements involved in the affairs of a scheme if an RE is required to include these agreements in any register of agreements.

Submissions

The majority of submissions supported the concept a register of agreements including agreements entered into by the RE as agent for scheme members.¹⁹⁷ The register would contain this information in one place and overcome any problem of inability to locate key contractual documents executed by the RE as agent for scheme members. Respondents supported controls on access to this register, given its potential commercial sensitivity.

CAMAC position

The CAMAC position is set out in Section 4.3.4.

¹⁹⁶ See, for instance, *Re Elders Forestry Management Ltd* [2012] VSC 287 at [15].

¹⁹⁷ Clarendon Lawyers, McCullough Robertson, Baker & McKenzie, IPA, Alan Jessup.

4.3.3 Agreements with external parties entered into by scheme members themselves

Scheme members may themselves enter into agreements with external parties during the course of a scheme, typically under the terms of some common enterprise scheme arrangements.

CAMAC position

The CAMAC position is set out in Section 4.3.4.

4.3.4 CAMAC position

The CAMAC proposal concerning an agreements register should apply whether or not the SLE Proposal is adopted.

Ambit of an agreements register for each scheme

CAMAC considers that the RE of each pooled or common enterprise scheme, whether a sole-function or multi-function RE, should have an obligation to establish and maintain an agreements register for each scheme that it operates. Each agreements register should be divided into three discrete categories:

- agreements entered into by the RE, as operator of the scheme, with scheme members or external parties
- agreements entered into by the RE, as agent for one or more scheme members, with external parties
- agreements entered into by scheme members themselves with external parties, pursuant to the operation of the scheme.

Each of the three categories in the agreements register for each scheme should be subdivided into a ‘continuing agreements’ section (where any rights, obligations or liabilities under the agreement are still on foot) and a ‘completed agreements’ section (where all rights, obligations and liabilities under the agreement have been discharged). The register should also include any material changes to recorded agreements.

The agreements register should be maintained throughout the life of a scheme. No agreement, whether or not still on foot, should be deleted from the register (except where recorded by mistake). The

purpose is to ensure a complete and available record of the affairs of each scheme.

Nature of the obligation

The obligation on the RE should apply to all continuing agreements and all future agreements, from the time of commencement of the statutory provisions regarding the agreements register. Completed agreements at the commencement date of the legislation should be exempt, given the potential administrative costs that this may involve, particularly for schemes that have been in operation for many years. The completed agreements section of agreements registers would build up over time.

The RE should be obliged to record details on the register within a reasonable time of any agreement being entered into by the RE as principal or agent, or the RE becoming aware of an agreement entered into by a scheme member as principal.

CAMAC notes that the compliance plan must ensure that adequate records of the scheme's operations are kept.¹⁹⁸ An agreements register would introduce standard requirements consistent with this obligation and have broad application to agreements forming part of a scheme, rather than this matter being left to the terms of each compliance plan.

CAMAC favours a requirement that the obligation on an RE to establish and maintain an agreements register be included in each scheme constitution.¹⁹⁹ This would ensure that the register is subject to the compliance plan and the annual audit. The requirement could be reinforced through the licensing requirements for the RE, backed up by ASIC audits and the possibility of revocation of the AFSL of the RE in the event of material failure to comply. In addition, there should be legislative sanctions against an RE for any material breach of its obligation to maintain the register, subject to an exemption from liability for failure to register an agreement that did not involve the payment of a material amount in the context of the scheme.

¹⁹⁸ s 601HA(1)(e).

¹⁹⁹ Under s 601GA(1).

As well as sanctions for breach, the RE of a scheme should not be entitled to exercise an indemnity right against particular scheme property unless and until:

- that particular property is included in the register of scheme property (see Section 4.4.3), and
- where the indemnity right arises in consequence of the RE entering into an agreement as principal in operating the scheme (under the current legal framework for schemes), that particular agreement is included in the register of agreements.²⁰⁰

CAMAC notes the concerns expressed in some submissions that an agreements register could pose a ‘significant compliance challenge’, particularly for agreements that cover multiple schemes, where the terms of agreements may change from time to time, or where agreements contemplate a series of further agreements. In CAMAC’s view, this points to the complexity that can arise, particularly under some common enterprise arrangements, and reinforces the need for each scheme to have an agreements register that provides a complete and accurate record of these affairs of the scheme.

Notification to affected parties

As part of the obligation to maintain the agreements register, the RE should have an obligation to inform any party to a registrable agreement when the agreement has been entered on the register, and any subsequent material change to the information on the register concerning that agreement.

Right to apply for agreements to be entered on the register

Parties to registrable agreements should have the right to apply to the RE to have their agreements included in the register, any material changes recorded, or any omissions or mistakes rectified, with the right to seek a court order if the RE does not comply. However, the right to seek a court order would no longer apply after

²⁰⁰ Under the current legal framework, an RE has indemnity rights against scheme property for its costs and remuneration and also for liabilities and obligations it incurs as principal in operating the scheme (see Section 2.3.2). Under the SLE Proposal, an RE would have indemnity rights against scheme property for its costs and remuneration: see Section 3.5 of this report.

a TRE or a new RE is appointed, or the scheme goes into external administration (see *Agreements register definitive*, below).

Access to the agreements register

Access to the agreements register should not be unrestricted, given that it may include commercially sensitive information. It should therefore be an exception to the general right of access to registers under s 173. Rather, access should only be given to:

- external administrators
- regulators
- counterparties to agreements, in regard to those agreements
- prospective REs, subject to specified conditions, including confidentiality and, for instance, either consent of the current RE or prior approval to that access by a special resolution of the scheme members actually voting
- any other person approved by the court (for instance a scheme member or prospective TRE) and pursuant to the terms of the court order.

Agreements register definitive

The agreements register should be definitive, in the sense that where there is a change of RE (through the appointment of a TRE or a new RE), or an external administrator dealing with the affairs of the scheme is appointed, the appointee can treat the register as a complete statement of the agreements involved in the scheme that bind the appointee (including for the purpose of s 601FS under the current legal framework). This would assist a new appointee to determine the ambit of its new responsibilities.

To provide flexibility, a TRE, a new RE, or an external administrator should have a general discretion, but not an obligation, to adjust the register for unrecorded agreements, or changes to recorded agreements, entered into before their appointment.

Remedies where agreements not recorded

In proposing that an agreements register be definitive, in the sense described above, CAMAC also proposes that the rights of parties to

agreements that should have been, but were not, recorded in the register, be protected. For this purpose:

- a counterparty should retain the right to enforce an agreement under which an RE is personally liable or a scheme member is the principal, whether or not the agreement is recorded on the register. An RE or scheme member should not be entitled to rely on the absence of an agreement from the register to avoid personal liability
- a counterparty should have a claim against an RE personally for any loss or damage incurred by the counterparty in consequence of that RE not recording the agreement etc in the agreements register before a TRE or a new RE was appointed or the scheme went into external administration.

4.4 Identification and recording of scheme property

4.4.1 Background

Particularly with common enterprise schemes, it is necessary to keep in mind the distinction between scheme property and other property involved in the operation of the scheme. Not all property used in relation to a scheme is scheme property. For instance, some agribusiness schemes have involved scheme members holding proprietary or other rights over various assets used in the common enterprise.

The RE of a scheme must hold scheme property ‘separately from property of the responsible entity and property of any other scheme’.²⁰¹ What constitutes scheme property is set out in the legislation.²⁰²

A clear determination of what is scheme property is important for a number of reasons. For instance, under the current legal framework, an RE who enters into an agreement as operator of a scheme (rather

²⁰¹ s 601FC(1)(i). The compliance plan of a scheme must set out the arrangements for ensuring that the requirement for separation of scheme property from other property is complied with (s 601HA(1)(a)).

²⁰² Definition of ‘scheme property’ in s 9.

than as agent for one or more scheme members) has indemnity rights against scheme property.²⁰³ Counterparties to those agreements have indirect rights of recovery against scheme property through the subrogation remedy.²⁰⁴ Under the SLE Proposal, those counterparties would have direct rights against scheme property.²⁰⁵ Also, a TRE or new RE would need to have a clear understanding of what is the property of the scheme that it has undertaken to operate. Likewise, in the VA or winding up of a scheme,²⁰⁶ the external administrator would need clearly to separate scheme and non-scheme property.

Issue

In addition to any accounting requirement, should an RE be required, from the commencement of a scheme, to establish a comprehensive register of scheme property, to be kept up-to-date by whoever is the RE from time to time?

Who should have access to that register and through what process?

4.4.2 Submissions

A number of respondents saw a requirement for the RE to maintain a register of scheme property as worthwhile, though some of those respondents questioned whether the accuracy of the register could be guaranteed.²⁰⁷

Some other respondents considered that the current requirements under s 601FC(1)(i), that the RE ensure that scheme property is clearly identified and separately held, sufficed, without the need for a register of scheme property.²⁰⁸

²⁰³ See Section 2.3.2 of this report.

²⁰⁴ See Section 2.3.3 of this report.

²⁰⁵ See Section 3.4 of this report.

²⁰⁶ See chapters 6 and 7 of this report.

²⁰⁷ Alan Jessup, IPA, Clarendon Lawyers.

²⁰⁸ Baker & McKenzie, ASIC, McCullough Robertson, Freehills, Financial Services Council, Property Funds Association, AAR, Primary Securities Ltd.

The predominant view in submissions was that, if a register of scheme property were introduced, access to it should be restricted, given its potential commercial sensitivity.²⁰⁹

4.4.3 CAMAC position

The CAMAC proposal concerning a register of scheme property should apply whether or not the SLE Proposal is adopted.

Duty to maintain a register of scheme property

CAMAC considers that the RE of either a common enterprise or a pooled scheme, whether a sole-function or multi-function RE, should have an obligation to establish and maintain a register of scheme property for each scheme that it operates.

For existing schemes, the register should identify all scheme property as at, and from, the date of commencement of the statutory requirement to establish the register. This obligation should apply to subsequent new schemes as at, and from, the date of their establishment. A register should be amended thereafter as scheme property is acquired or disposed of.

Implementation

CAMAC favours a requirement that the obligation on the RE to maintain the register of scheme property be included in each scheme constitution.²¹⁰ This would ensure that the register is subject to the compliance plan and the annual audit. The requirement could be reinforced through the licensing requirements for the RE, backed up by ASIC audits, and the possibility of revocation of the AFSL of the RE in the event of material failure to comply. In addition, there should be legislative sanctions against an RE for any breach of its obligation to maintain the register, with an exemption from liability for de minimis breaches.

The RE of a scheme should not be entitled to exercise an indemnity right against particular scheme property unless and until:

- that particular property is included in the register of scheme property, and

²⁰⁹ AAR, IPA, Alan Jessup.

²¹⁰ Under s 601GA(1).

- where the indemnity right arises in consequence of the RE entering into an agreement as principal in operating the scheme (as under the current legal framework), that particular agreement is included in the register of agreements (see Section 4.3.4).²¹¹

Access to the register

CAMAC considers that the principles for access to the register of scheme property should, in general, be similar to those for access to the agreements register (see Section 4.3.4), given the potentially commercially sensitive nature of what constitutes scheme property.

A register of scheme property would include the portfolio assets of the scheme. The Parliamentary Joint Committee on Corporations and Financial Services report *Inquiry into the collapse of Trio Capital* (May 2012) has recommended that the government release a consultation paper to investigate the best mechanism for an RE to disclose scheme assets at the asset level.²¹²

Register of scheme property definitive

The register should be definitive in the same way as with the agreements register, namely that any TRE, new RE or external administrator is entitled to treat the register of scheme property, as at the date of their appointment, as an exhaustive statement of scheme property (subject to the appointee permitting adjustments). Given this, affected parties (for instance, persons who dispute that certain property on the register is scheme property) should have comparable rights to inspect the register of scheme property, and apply for an amendment to the register, as with the register of agreements (see Section 4.3.4).

²¹¹ Under the current law, an RE has indemnity rights against scheme property for its costs and remuneration and also for liabilities and obligations that it incurs as principal in operating the scheme (see Section 2.3.2). Under the SLE Proposal, an RE would have indemnity rights against scheme property for its costs and remuneration (see Section 3.5).

²¹² Recommendation 9.

4.5 Use of scheme property

4.5.1 Reform proposal

The property of a particular scheme can be used only for the purposes of that scheme.

Issues

Should this policy approach be enacted?

Should there be any exceptions? If so, in what circumstances and for what reasons?

4.5.2 Explanatory note

Under general trust law principles, it is a breach of fiduciary duty for a trustee to use property of the trust for purposes unrelated to that trust.

The constitution of a scheme must make adequate provision for various matters, including the powers of the RE in relation to ‘making investments of, or otherwise dealing with, scheme property’.²¹³ A view has been taken that an RE may validly deal with property of a scheme in any manner permitted in the scheme’s constitution, including by using scheme property to pay debts incurred by the RE in operating another scheme. The reform proposal sought to make clear that scheme property could only be used for the purposes of that scheme, regardless of what was permitted in the scheme constitution.

4.5.3 Submissions

Various respondents supported the principle in the reform proposal, though sometimes qualified with exceptions, such as for use of scheme property for value or with the approval of scheme members.²¹⁴

²¹³ s 601GA(1)(b).

²¹⁴ Alan Jessup, Henry Davis York, IPA, McCullough Robertson, Property Funds Association, AAR, Clarendon Lawyers, Primary Securities Ltd.

Other respondents questioned the need for the reform proposal, arguing that the current law suffices or that the proposal could have unintended consequences, for instance for schemes whose constitutions have a broad investment mandate that would ordinarily permit an RE to lend funds on commercial terms to another scheme operated by the same RE.²¹⁵

4.5.4 CAMAC position

CAMAC observes at the outset that determining what constitutes scheme property is important for various reasons, including to assess the propriety of certain conduct. For instance, pre-payments by investors to an RE for its services become the personal property of the RE, not scheme property, unless otherwise stipulated. The RE is not obliged to set those payments aside as scheme property, to be drawn on only as and when the RE provides the services.

If the SLE Proposal is adopted

The SLE Proposal would overcome any property-commingling problem, as each MIS would hold its own scheme property. Also, the SLE Proposal would impose an obligation on the RE and its officers, in their managerial role, to act in the interests of the MIS and consistently with the constitution of the scheme. Likewise, the compliance committee has a role in safeguarding the interests of the scheme members. In light of these considerations, a legislative statement that the property of a particular scheme can be used only for the purposes of that scheme would not appear necessary as an additional safeguard.

If the SLE Proposal is not adopted

CAMAC supports the principle behind the reform proposal that property of a scheme can be used only for the purposes of that scheme. However, taking into account the existing statutory obligations of the RE, its officers and employees under ss 601FC-601FE, it is difficult to justify additional legislative controls, unless these provisions prove to be ineffective.

²¹⁵ ASIC, Freehills, Baker & McKenzie, Property Council of Australia, McMahon Clarke Legal, Financial Services Council.

4.6 Informing scheme creditors of a change of RE

4.6.1 Reform proposal

Where the RE of a scheme changes, the new RE must give notice of that change to all counterparties included in the ‘continuing agreements’ section of the agreements register and to any other counterparty of which the new RE is aware.

Issues

Should the policy approach in the reform proposal be enacted?

What, if any, consequences should follow where an RE fails to inform a counterparty?

4.6.2 Explanatory note

This proposed reform would help to ensure that persons who have transacted with an RE as the operator of a particular scheme are notified of any change of RE of that scheme where any rights, obligations or liabilities under an agreement with the RE in relation to the scheme are still on foot.

4.6.3 Submissions

Various respondents supported, or did not oppose, the reform proposal, though one view was that failure to notify a change of RE should not affect the validity of any relevant agreement.²¹⁶

Other respondents questioned whether there was evidence of a problem that justified the reform proposal, commenting that the costs associated with notification may outweigh any regulatory benefit, while the obligation to notify may be difficult to enforce. It may be unduly onerous on a new RE for no practical benefit.²¹⁷

²¹⁶ Clarendon Lawyers, McMahon Clarke Legal, Henry Davis York, IPA, Baker & McKenzie, Primary Securities Ltd, Property Council of Australia.

²¹⁷ ASIC, AAR, McCullough Robertson, Financial Services Council, Freehills, Alan Jessup, Ashurst Australia, Property Funds Association.

4.6.4 CAMAC position

Who is the RE or TRE

An initial general question affecting counterparties is who is the RE or TRE of a scheme at any particular time, for the purpose of entering into agreements with the RE or TRE.

Subsection 601FJ(1) states that the company named in the ASIC record of registration as the RE or TRE remains so until the record is altered. However, doubts on whether this record is definitive have arisen from the Federal Court decision in *Huntley Management Ltd v Australian Olives Ltd (No 2)*.²¹⁸ The Court ruled that the provision does not, on its proper construction, defeat the requirements for the valid appointment of an RE or a TRE under ss 601FK-601FQ, as operated upon by s 601FJ(2). Rather, s 601FJ(1) depends on, and assumes the existence of, an otherwise effective appointment, or change, of RE or TRE.²¹⁹

While acknowledging this judicial reasoning, CAMAC considers that counterparties to agreements need certainty as to who is the RE or TRE of a scheme and who therefore can enter into agreements as operator of the scheme. In principle, counterparties should be entitled to a conclusive presumption that the RE or TRE at a particular time is the person named as such on the ASIC record of registration at that time, even if it is subsequently determined that the entity was not then validly appointed.

The language of s 601FJ should be amended to place this outcome beyond doubt. This amendment should be made whether or not the SLE Proposal is adopted.

The following comments on whether additional measures to inform scheme creditors of a change of RE are necessary are based on the assumption that an amendment to this effect will be made.

²¹⁸ [2009] FCA 686.

²¹⁹ This issue was noted in the submission by Alan Jessup.

A change of RE

If the SLE Proposal is adopted

Under the SLE Proposal, the RE would be the agent of the MIS (which would be the principal), with a change of RE constituting a change of agent.

Counterparties would be protected at the time of entry into an agreement by the proposed 'indoor management rule' under the SLE Proposal, which provides that where an RE purports to act as agent for an MIS and the counterparty is bona fide and has no notice of any relevant limitation on the RE's so acting, the RE would be deemed to be acting within the scope of its authority. The counterparty could claim directly against the scheme property, held by the MIS.

Counterparties to a particular agreement would have no need to be informed of a subsequent change of RE, given that their remedies are directly against the property of the scheme, held by the MIS. Therefore, the reform proposal would not be necessary.

If the SLE Proposal is not adopted

The most efficient and effective way to keep external parties informed of the identity of the RE or TRE is to make the ASIC record of registration in s 601FJ(1) definitive, in the way proposed above. A counterparty could check that ASIC record before entering into agreements with the RE.

This reliance on a publicly accessible record would be more straightforward than imposing an obligation on a new RE to notify existing counterparties, with questions arising as to the means of notification and the penalties for non-compliance. Therefore, the reform proposal would not be necessary.

4.7 Rights of scheme creditors against scheme property

4.7.1 Current position

Under the current legal framework, counterparties to agreements entered into with the RE as operator of a scheme, while having direct rights against the personal assets of the RE²²⁰ (unless they have agreed to limited recourse rights only), cannot make a direct claim on the property of that scheme. Any claims concerning scheme property, under either the subrogation remedy or under limited recourse rights, are limited to the lawful indemnity claims that the RE can make against scheme property.²²¹

Counterparties with limited recourse rights have, in effect, agreed to the risk that their claims may be affected by any improper conduct of the RE that affects its indemnity claims against scheme property. However, the subrogation remedy arises by operation of trust law, not by agreement. A counterparty may find that its rights of recovery under the subrogation remedy have been adversely affected by the improper conduct of an RE, over which it has no control.

4.7.2 The reform proposal

Counterparties to agreements entered into by the RE as operator of a particular scheme will have the right to claim directly against the property of that scheme, except to the extent that they agree otherwise.

4.7.3 Explanatory note

The reform proposal would give counterparties to agreements where the RE has acted as principal a direct right against scheme property, not dependent on the RE having acted within its powers and otherwise properly. In this respect, the reform would be analogous to the corporate indoor management rule²²² and more closely align the rights of counterparties with those of corporate creditors. The

²²⁰ See Sections 2.3.1 and 2.3.3 of this report.

²²¹ See Section 2.3.3 of this report.

²²² ss 128,129.

rationale for this change is the typically entrepreneurial nature of many schemes.

The reform proposal, while protecting counterparties, would not affect the limitations on the RE's own exercise of its indemnity rights against scheme property.²²³

4.7.4 Submissions

A number of respondents supported the creation of a right for counterparties to agreements with the RE as operator of a scheme to claim directly against the property of that scheme, rather than having to rely on subrogation to the RE's right of indemnity against scheme property.²²⁴ It was argued that this direct right of recovery for counterparties would assist the process of entering into agreements, including the speed with which agreements could be negotiated.

Various respondents opposed the reform proposal.²²⁵ Concerns were expressed that it involved a fundamental alteration to the application of trust law principles to schemes and that replacement of the subrogation remedy against scheme property with direct rights of recovery against that property may have the potential to reduce the protection currently afforded to scheme members, given that the RE must hold scheme property on trust for scheme members.²²⁶

4.7.5 CAMAC position

If the SLE Proposal is adopted

Under the SLE Proposal, counterparties would have direct rights against scheme property (held by the MIS) for agreements entered into by the RE as agent of the MIS, including under the proposed indoor management rule. The need for a reform proposal would not arise.

²²³ See Section 2.3.2 of this report.

²²⁴ IPA, McCullough Robertson, AAR, Freehills (qualified support).

²²⁵ Ashurst Australia, Alan Jessup, ASIC, Baker & McKenzie, Property Council of Australia, Financial Services Council, Property Funds Association, The Trust Company, McMahon Clarke Legal, Clarendon Lawyers, Primary Securities Ltd.

²²⁶ s 601FC(2).

If the SLE Proposal is not adopted

CAMAC considers that the current trust law based procedure for scheme counterparties to gain access to scheme property, involving subrogation to the RE's indemnity rights, while preserving that property for the benefit of scheme members where the RE has acted improperly, is inappropriate for schemes as commercial vehicles.

Providing counterparties with a direct right of recovery against scheme property, without that right being lost through the improper conduct of the RE, would create greater consistency in approach for parties dealing with schemes and companies as alternative forms of investment and entrepreneurial activity.

Adoption of this direct right of recovery would call into question the further use of limited recourse rights clauses in agreements between an RE as operator of a scheme and a counterparty.

The RE would retain its current indemnity rights against scheme property, with the limitations that apply to the exercise of those rights, including that the RE has properly performed its duties. Those limitations would only affect the recovery rights of the RE against scheme property and not the recovery rights of scheme creditors against that property.

4.8 Tort claims and statutory liability

4.8.1 Outline of the issues

In some cases, persons may suffer injury or other detriment giving rise to a potential claim in tort. This could arise in circumstances related to the operation of a particular scheme. For instance:

- a person having no legal relationship with the RE may be injured while upon land that is scheme property
- an owner of real property that is adjacent to land that is scheme property may suffer detriment in consequence of activities undertaken on that scheme property.

An RE may also breach worker health and safety, consumer protection or other laws in operating a scheme.

An RE may be personally liable where, for instance, it can be established that an injury, loss or other detriment was suffered in circumstances where the RE had breached a common law duty or a statutory obligation. The RE may be entitled to be indemnified for that liability from the property of the scheme, provided its conduct was not a breach of the ‘proper performance’ of its duties.²²⁷ An RE has specific duties in operating a scheme.²²⁸ However, questions may arise about the circumstances in which breaches by an RE of other general or statutory laws would constitute failure properly to perform its duties, for the purpose of denying the indemnity right of the RE against scheme property.²²⁹

Issues

Is it necessary to clarify the circumstances in which an RE should, or should not, be entitled to obtain an indemnity from scheme property in consequence of some common law or statutory breach by the RE?

In what circumstances, if any, and for what reasons, should tort claimants have direct rights against scheme property?

4.8.2 Submissions

Various respondents were of the view that the general law principles concerning indemnity rights were sufficient, with parties relying on established case law, with judicial guidance where necessary.²³⁰ Some other respondents supported a legislative clarification of indemnity rights.²³¹

²²⁷ s 601GA(2)(b).

²²⁸ s 601FC.

²²⁹ In *Gatsios Holdings v Kritharas Holdings (in Liquidation)* [2002] NSWCA 29, damages were awarded against the trustee of a trading trust in consequence of the trustee having breached consumer protection laws in the course of carrying on the business of the trust. The Court held that the trustee’s breach did not deny it the right to claim against trust property to cover the damages.

A more restricted approach to the right of indemnity was taken in *Nolan v Collie & Merlaw Nominees Pty Ltd (in liq)* [2003] VSCA 39. The Court expressed a concern (at [45]) that ‘mischievous trustees might seize upon an almost unfettered right to indemnity as justifying improper deprecations of trust funds, contrary to their obligation not to abuse their position’.

²³⁰ IPA, Baker & McKenzie, ASIC, Freehills, Henry Davis York, The Trust Company, McCullough Robertson.

²³¹ AAR, Clarendon Lawyers, Property Funds Australia.

No respondent supported legislative initiatives concerning tort claims.

4.8.3 CAMAC position

RE duty to the scheme

An RE should not be entitled to contract out of any breach of its duties properly to manage a scheme. Any provision in a scheme constitution, or otherwise, that affords an RE an indemnity for any form of maladministration on its part in relation to that scheme should be unenforceable. This should apply whether or not the SLE Proposal is adopted.

RE duty to external parties

If the SLE Proposal is adopted

Under the SLE Proposal, in any situation where the RE was acting as agent of the MIS, or the indoor management rule applied, tort claimants would have direct rights against scheme property, held by the MIS. In other circumstances, claimants dealing with the RE would have direct remedies against the RE.

If the SLE Proposal is not adopted

Under the current legal framework for schemes, an external party would sue the RE as operator of the scheme. The RE would be entitled to be indemnified from scheme property for any liability incurred, provided the conduct of the RE was not in breach of the proper performance of its duties. CAMAC does not see any need to amend this principle.

5 Changing the RE of a viable scheme

This chapter discusses the question in the terms of reference concerning the effectiveness of the temporary responsible entity (TRE) framework in the transfer of the RE of a viable scheme. It considers this issue in the broader context of the various means by which the RE of a viable scheme may be replaced, possible impediments to achieving that transfer, and the role of the TRE in that process.

5.1 Problems in practice

5.1.1 Position of the RE

A scheme cannot be registered, or continue to operate, without an RE, which must be a public company that holds an AFSL authorising it to operate a scheme.²³² The RE operates the scheme according to the terms of the scheme constitution and subject to the powers and duties given to it under the Corporations Act and relevant common law principles.

An RE may be operating a scheme that is financially sound. However, for various reasons, the RE may no longer be eligible to be an RE,²³³ or may, through its insolvency or otherwise, be unable to continue operating the scheme.²³⁴ An RE may also, for various reasons, wish to retire from that position. Also, scheme members may wish to change the RE.

The RE of a scheme can, at any time, be replaced by vote of scheme members.²³⁵ In addition, a court may appoint a TRE as an interim body while a new RE is being sought.²³⁶ However, experience over

²³² ss 601EB(1)(d), 601FA, 601FK.

²³³ For instance, the RE may have acted in breach of the terms of its AFSL, leading to loss of that licence.

²³⁴ For instance, an RE may become insolvent for reasons unrelated to its role as operator of a particular scheme and therefore no longer be capable of operating the scheme.

²³⁵ s 601FM.

²³⁶ s 601FP and Corp Reg 5C.2.02.

recent years, particularly with some common enterprise schemes, points to difficulties that have arisen with the procedures for replacing an RE, or appointing a TRE, and the need for some adjustments to the regulatory structure.

5.1.2 Replacing the RE

An entity approached to become a TRE or new RE of a scheme will typically first conduct due diligence on the viability of the scheme, and the financial and legal consequences of accepting that role.

The ability to conduct due diligence, and the time involved, can be affected by the degree to which the incumbent RE is willing to provide assistance. Lack of cooperation can impede that process. Also, there may be disincentives to changing an RE, such as remuneration or other arrangements designed to favour or entrench the incumbent RE, or having that effect.

Even where a suitable entity agrees to be put forward as a new RE, the ability of scheme members to change the RE can be affected by the voting requirements, in particular the high approval threshold for members of an unlisted scheme to remove an incumbent RE.

These matters are further discussed in Sections 5.2-5.4 of this chapter.

5.1.3 Appointing a TRE

Where it is necessary to replace the RE or the RE wishes to retire from that position, but a new RE is not available, the court can appoint a TRE to operate a scheme on an interim basis while a new RE is sought.²³⁷

Few TREs have been appointed. To some extent this may reflect possible limitations on the court power to appoint a TRE, and the restrictions on who can be a TRE. However, the principal reason for the low utilisation of the TRE procedure appears to be the disincentives under the current legal framework for entities to undertake the role of TRE, in particular that a TRE (like a new RE) becomes subject to the outstanding obligations and liabilities, as well

²³⁷ s 601FP and Corp Reg 5C.2.02.

as the rights, of the former RE in operating the scheme,²³⁸ while also being subject to various statutory duties as the new operator of the scheme.²³⁹

Particularly where the need to appoint a TRE is urgent, the continuation of a viable scheme may be jeopardised by the lack of a willing and suitable entity to take up the office of TRE on short notice.

These, and other, matters specifically affecting a TRE are further discussed in Sections 5.5-5.11 of this chapter.

5.2 Conducting due diligence

5.2.1 Obtaining assistance

Eligible entities will seek to conduct due diligence on a scheme before indicating their willingness to accept the position of TRE or new RE.

The proposed register of agreements related to the scheme²⁴⁰ and the proposed register of scheme property²⁴¹ would assist a prospective TRE or new RE in this due diligence exercise. As proposed by CAMAC, those registers would constitute a definitive statement of the relevant agreements and property of the scheme that would bind a TRE or new RE.

In addition, an incumbent RE may choose to assist the due diligence process, but is under no statutory obligation to do so. A former RE is required to provide reasonable assistance to facilitate the change of RE only *after* a new RE is appointed.²⁴²

²³⁸ s 601FS.

²³⁹ The s 9 definition of 'responsible entity' includes a specific reference to a TRE. The reasons for the reluctance of parties to undertake the role of TRE are also discussed in D Walter, 'Managed investment schemes' (2011) 23(1) *Australian Insolvency Journal* 12.

²⁴⁰ See Section 4.3.4 of this report.

²⁴¹ See Section 4.4.3 of this report.

²⁴² s 601FR.

Issue

In what circumstances, if any, should an existing RE have an obligation to assist a prospective new RE or TRE to conduct due diligence?

5.2.2 Submissions

Most respondents supported an obligation on an RE to assist a prospective TRE or new RE, but with appropriate controls to prevent abuses such as spurious investigations by outside parties or competitors. Possible controls included that the obligation would only arise pursuant to a court order or at the request of a minimum threshold number of scheme members, and that those receiving the information should be subject to confidentiality obligations.²⁴³ Some other respondents considered that current law and practice sufficed, or were concerned about forcing assistance in a ‘contested’ situation.²⁴⁴

5.2.3 CAMAC position***If the SLE Proposal is adopted***

The due diligence exercise, while still needing to cover the overall financial position of the scheme, would otherwise be simplified. The RE would be the agent of the MIS in entering into agreements forming part of the scheme and therefore would not itself incur any rights, obligations and liabilities under these agreements that would need to pass to a TRE or new RE.

CAMAC supports an incumbent RE having an obligation to provide reasonable assistance to a prospective TRE or new RE in its due diligence exercise, in the same manner as if the SLE Proposal is not adopted (see below)

If the SLE Proposal is not adopted

The due diligence exercise may need to be extensive. In addition to developing an understanding of the financial position of the scheme,

²⁴³ ASIC, Henry Davis York, Primary Securities Ltd, Clarendon Lawyers, McMahon Clarke Legal, The Trust Company, AAR, IPA, Alan Jessup.

²⁴⁴ Financial Services Council, McCullough Robertson.

close consideration would need to be given to the implications for a TRE or new RE of s 601FS, being the statutory transfer to it of the rights, obligations and liabilities personally incurred by the incumbent RE in operating the scheme. For instance, agreements entered into by the RE as operator of the scheme would need to be reviewed to determine which of them impose personal liability on the RE and which provide only limited recourse rights to the counterparty.

In some cases, such as where the current RE is seeking to retire from that position, it may willingly offer assistance in the due diligence exercise. However, in a contest for the position of RE, an incumbent RE may be reluctant to assist an entity that it considers to be its competitor.

To balance these considerations, and avoid possible abuse, an incumbent RE should only have an obligation to provide reasonable assistance to a prospective TRE or new RE:

- upon request from at least 5% of scheme members, or
- when directed by court order (for instance, a court may give directions to assist the due diligence exercise of a prospective TRE).

The prospective TRE or new RE should also be obliged to treat any commercially sensitive information obtained in the due diligence exercise as confidential, other than for its reasonable use in that process.

5.3 Disincentives to replacing an RE

5.3.1 The issues

The willingness of an eligible entity to stand for election as the new RE of a scheme can be affected by pre-existing arrangements concerning how remuneration is to be paid to an RE.

Also, some agreements forming part of the scheme may discourage members from changing an RE in that there would be detrimental consequences for the scheme if an incumbent RE is replaced.

5.3.2 Remuneration arrangements

Current position

The scheme constitution must set out the rights of the RE to be paid fees out of scheme property.²⁴⁵ The legislation preserves any rights of a former RE to be paid fees for the performance of its functions before it ceased to be the RE.²⁴⁶ However, the legislation does not deal with the respective remuneration rights of the former and new RE where there is a transfer of responsibilities during a financial period. Rather, this matter is left to the terms of individual scheme constitutions.

In *Huntley Management Limited v Australian Olives Limited*,²⁴⁷ an RE was replaced during the course of a financial year. The new RE claimed an entitlement to be paid on a pro rata basis for that part of the annual management fees for the financial year that was referable to the period that it operated the scheme during that year. The former RE, which had been paid the entire management fees for the financial year at the commencement of that year, claimed to be entitled to retain all those fees under the terms of the constitution of that scheme.

The Full Federal Court determined that under the relevant terms of the constitution of the scheme:

a debt in favour of [the former RE] for the whole of the management fee payable by the investors in those projects in respect of each year comes into existence at the beginning of each year. ... Once the annual amount was paid, the investors' debts to [the former RE] as the responsible entity of Projects 1 and 2 were discharged. There was nothing to which [the new RE] could accede upon its appointment as the new responsible entity for those projects.²⁴⁸

Accordingly, no pro rata portion of the management fees paid to the former RE was recoverable by the new RE.

Likewise, in *Saker, in the matter of Great Southern Managers Australia Ltd (Receivers and Managers Appointed)* (in

²⁴⁵ s 601GA(2)(a).

²⁴⁶ s 601FS(2)(a).

²⁴⁷ [2010] FCAFC 98.

²⁴⁸ at [24].

liquidation),²⁴⁹ the relative rights of the former RE and the replacement RE to certain funds turned on the terms of the constitution of the scheme, which provided the former RE with priority rights.

As observed by one commentator:

There is a real risk that, if the constitution [of a scheme] is in similar terms to those of the projects considered in *Huntley Management*, management fees will not be able to be received until the next annual payment period arrives.

and:

Great Southern Managers and *Huntley Management* both make it clear that it is permissible for incumbent responsible entities to receive and retain substantial benefits out of 'scheme property' even after their removal.²⁵⁰

It is arguable that leaving all matters concerning the remuneration of the RE to the terms of a scheme's constitution provides an opportunity to draft that constitution in a manner that gives an incumbent RE unearned benefits in the event of being replaced. Members of a viable scheme may also find it more difficult to change an incumbent RE if the management fee relating to a significant period of future time has already been paid to that RE.

The *Review of the Managed Investments Act 1998* (2001) (the Turnbull Report) recommended that the legislation ensure that payment of fees or a right to an indemnity cannot be claimed in advance of an RE's proper performance of its duties.²⁵¹

Issue

What, if any, statutory controls should be placed on RE remuneration arrangements to cover the situation where an RE is replaced during a financial year, and for what reasons?

²⁴⁹ [2010] FCA 1080.

²⁵⁰ D Walter, 'Developments in the replacement of responsible entities for managed investment schemes' (2010) 11(4) *Insolvency Law Bulletin* 79.

²⁵¹ rec 6.

Submissions

There was general support for the principle that an RE should only be entitled to claim remuneration for the period that it had performed its duties,²⁵² though some respondents questioned whether legislation was necessary to give effect to this principle.²⁵³ Various proposals were put forward to implement this approach, including an express prohibition on an RE receiving fees in advance, or an obligation on an RE to repay any advance fees received for any period during which the RE was no longer in that role.

CAMAC position

The SLE Proposal does not affect this matter.

An RE should receive remuneration only for the period during which it performs that role. There should be a statutory prohibition on an RE being paid any remuneration in advance for more than a limited period, say, three months. Also, where an RE retires or is replaced, it should be under a statutory obligation to refund the portion of any advance remuneration that relates to the period after it ceased to be the RE.

5.3.3 Arrangements between an RE and external parties

Current position

Some arrangements between an RE and an external party may, in effect, inhibit scheme members from replacing the RE. For instance, an RE may enter into an agreement whereby the counterparty will lend funds to the scheme provided that the RE does not change or any such change is approved in advance by the counterparty.

The consequence of entering into such a debt covenant may be that, while scheme members are legally entitled to change the RE, they may be discouraged from doing so if the result, for instance, is that the debt facility is withdrawn or the loan becomes immediately repayable.

²⁵² ASIC, IPA, Alan Jessup, Clarendon Lawyers, Primary Securities Ltd.

²⁵³ McCullough Robertson, Property Funds Association, Financial Services Council, AAR.

Issue

What, if any, statutory controls should be placed on agreements that are conditional on a particular RE remaining as operator of a particular scheme?

Submissions

A majority of respondents who considered this matter supported a prohibition on agreements that place direct or indirect restrictions on the exercise of the statutory rights of scheme members to replace the RE.²⁵⁴ Examples of indirect restrictions would include ‘poison pills’, such as constitutional provisions that require the RE to be paid a large sum out of scheme property if that entity is replaced.

CAMAC position

The SLE Proposal does not affect this matter.

CAMAC recognises that in some circumstances there may be good commercial reasons for counterparties to include provisions concerning the continuation of a particular party as the RE of a scheme, or approval of a replacement RE. However, such provisions, whether arising in scheme constitutions or in private agreements, should be enforceable only if they do not unreasonably inhibit the right of scheme members to replace the RE.

5.4 Voting requirements for members to change an RE

5.4.1 Current position

Scheme members holding at least 5% of the total voting rights of members may call a meeting of members²⁵⁵ to consider and vote on a resolution that the RE be removed and a resolution to choose a new RE.

The RE of a listed scheme may be replaced by two ordinary resolutions of scheme members, being a simple majority of votes

²⁵⁴ ASIC, Clarendon Lawyers, Alan Jessup, Primary Securities Ltd, The Trust Company.

²⁵⁵ s 252D.

cast by members entitled to vote on the resolutions.²⁵⁶ The RE and its associates may vote any interests they hold as members on those resolutions.²⁵⁷

The replacement of an RE of an unlisted scheme requires two ‘extraordinary resolutions’ of scheme members, being the approval of at least 50% of the total votes that can be cast by members entitled to vote, whether or not cast²⁵⁸ (excluding any votes by the RE and its associates, which are ineligible to be voted on the resolutions²⁵⁹). The extraordinary resolution formula for unlisted schemes makes it impossible for RE replacement resolutions for these schemes to be passed unless at least 50% of the total votes held by members of the scheme are involved in the voting process.

The Turnbull Report raised the question whether the current requirement for extraordinary resolutions to remove an RE of an unlisted scheme and to appoint a new RE of that scheme should be replaced with simple special resolutions (75% of votes cast at the meeting) or, alternatively, special resolutions with the added requirement that votes cast in favour must constitute at least 25% of the total votes of scheme members.²⁶⁰

Issue

What changes, if any, should be made to the current voting requirements concerning the replacement of an RE of an unlisted scheme by the members of that scheme, and why?

5.4.2 Submissions

Various respondents supported a change to the current extraordinary resolution voting requirement for unlisted schemes, noting that it is a

²⁵⁶ See ss 601FM(1), 252L(1B)(c) and 253J(2).

²⁵⁷ Where a scheme is listed, the RE and its associates are entitled to vote their interests on resolutions to remove the RE and to choose a new RE: s 253E.

²⁵⁸ s 601FM and the definition of ‘extraordinary resolution’ in s 9.

²⁵⁹ For an unlisted scheme, the RE and its associates are not entitled to vote their interests on resolutions to remove the RE and choose a new RE, as they would have an interest in those resolutions: s 253E. That provision specifically allows the RE and its associates to vote on those resolutions where the scheme is listed.

²⁶⁰ rec 2.

very high barrier to changing an RE of such schemes.²⁶¹ Various alternative formulae were proposed such as:

- simple resolutions, provided at least 25% of total votes of scheme members are cast
- special resolutions
- special resolutions, provided at least 25% of total votes of scheme members are cast.

Also, excluded votes (that is, votes that are ineligible to be voted) should not be counted for the purpose of determining the total votes of scheme members.

Some respondents supported the current voting requirements, arguing, for instance, that the current threshold was deliberately set high due to the possible consequences of changing the RE.²⁶²

5.4.3 CAMAC Position

The SLE Proposal does not affect this matter.

The current ‘extraordinary resolution’ voting requirements for scheme members to replace the RE of an unlisted scheme are out of step with general voting requirements in the Corporations Act and can make it extremely difficult for members of these schemes to replace an RE.

The voting requirements to replace the RE of an unlisted scheme should be changed to simple majorities of the votes of scheme members cast at the meeting (in person or otherwise), provided that the total of the votes cast (for and against) on each of the resolutions constitutes at least 25% of the total votes of scheme members (excluding votes that are ineligible to be voted on the resolution²⁶³).

This amended voting test would reduce the barrier to changing an RE of an unlisted scheme, while still ensuring that the votes cast at

²⁶¹ ASIC, Henry Davis York, Alan Jessup, IPA, Clarendons Lawyers, Ashurst Australia, Primary Securities Ltd.

²⁶² McCullough Robertson, Property Funds Association, McMahon Clarke Legal, Property Council of Australia, AAR.

²⁶³ s 253E.

the scheme meeting reflect a significant proportion of the votes held by scheme members as a whole.

5.5 Appointing a TRE

5.5.1 Current position

A court may appoint a TRE to operate a scheme as an interim measure while a new RE is sought. The court may act where:

- application is made by the RE, a scheme member or ASIC
- there is an eligible entity²⁶⁴ willing to act as the TRE, and
- the court is satisfied that the appointment of that entity as the TRE is necessary to protect scheme property or that it is in the interests of scheme members.²⁶⁵

Application by the RE

An RE may wish to retire from that role. It can initiate the replacement process by calling a meeting of scheme members, but cannot unilaterally resign in the absence of a willing and eligible replacement RE that has been approved by those members.²⁶⁶

In the absence of a replacement RE, the current RE (through its external administrator if the RE is in external administration) can apply to the court for the appointment of a TRE to the scheme.²⁶⁷ The court may make this appointment (assuming there is an eligible entity willing to undertake that role) where it is satisfied that the appointment is necessary to protect scheme property or is in the interests of scheme members.

Application by a scheme member or ASIC

Where the RE is ineligible to continue in that role

If the RE of a scheme no longer meets the statutory requirements to be an RE (for instance, if the AFSL of the RE is withdrawn for any

²⁶⁴ A TRE, like any other RE, must be a public company that holds an AFSL to operate a scheme: ss 601FA, 601FK.

²⁶⁵ s 601FP.

²⁶⁶ s 601FL(1).

²⁶⁷ s 601FL(3).

reason, including that the RE has gone into external administration²⁶⁸), ASIC or a scheme member may apply to the court for the appointment of a TRE.²⁶⁹ The court may make this appointment (assuming there is an eligible entity willing to undertake that role) where it is satisfied that the appointment is in the interests of scheme members.

General provision

ASIC or a scheme member may apply to the court for the appointment of a TRE if the applicant:

reasonably believes that the appointment is necessary to protect scheme property or the interests of members of the scheme.²⁷⁰

For instance, an RE may become financially distressed for reasons unrelated to its role with a particular scheme, but this may impinge on its ability to continue to operate the scheme effectively.

A matter that has not been considered by the court is an application by ASIC or a member under the general provision to appoint a TRE where the members have voted to remove an RE, but there is no suitable new RE ready to take the appointment. The problem lies with the statutory obligation on an RE to wind up a scheme that it operates where members resolve to remove the RE but do not, at the same meeting, pass a resolution to appoint a new RE.²⁷¹ On one view, that explicit statutory obligation to wind up the scheme in the absence of a new RE having been approved by scheme members would negate the right of the court to appoint a TRE under the general provision. A contrary view is that the appointment of a TRE by the court would overcome the rationale behind the statutory obligation to wind up the scheme (namely, that a scheme cannot operate in the absence of an RE).

²⁶⁸ For instance, ASIC has the discretion to suspend or cancel the AFSL of an RE that has gone into external administration: s 915B(3)(b). ASIC may allow the AFSL to continue for a specific period or for a specified purpose: s 915H.

²⁶⁹ s 601FN.

²⁷⁰ Corp Reg 5C.2.02. This general provision does not include a power for the court to make an order based on the application. This creates some doubt about the court's powers if such an application were made.

²⁷¹ s 601NE(1)(d).

The ALRC/CASAC report envisaged a role for the TRE in these circumstances:

If the investors agree to remove the scheme operator but cannot agree on a replacement operator, the current operator should be obliged to apply to the court for a temporary scheme operator. An investor or the ASC may apply for appointment of a temporary scheme operator if the removed operator does not act.²⁷²

Issue

What changes, if any, should be made to the power of the court to appoint a TRE and why?

5.5.2 Submissions

Respondents supported the court having a general power to appoint a TRE, including where scheme members have voted to remove the RE but without a new RE having been appointed.²⁷³

5.5.3 CAMAC position

The SLE Proposal does not affect this matter.

The court should have a general and unqualified power to appoint an eligible and willing entity to be the TRE of a scheme whenever the court considers that this appointment is in the interests of scheme members or is necessary to protect scheme property. Appointment of a TRE will allow a scheme to continue to operate while a replacement RE is sought or other options are considered. The power of the court should not be read down by the terms of s 601NE(1)(d) or otherwise.

The RE, ASIC or any scheme member should have standing to make the application.

CAMAC elsewhere recommends that a scheme administrator or scheme deed administrator (if a VA procedure for schemes is

²⁷² vol 1 para 11.17. See also vol 2 draft s 183C (p 116).

²⁷³ ASIC, McMahon Clarke Legal, Clarendon Lawyers, Alan Jessup, Property Council of Australia, Henry Davis York, McCullough Robertson, The Trust Company, AAR, IPA.

introduced) also have standing to apply to the court for the appointment of a TRE.²⁷⁴

5.6 Eligibility to be a TRE

5.6.1 Current position

Currently, a TRE, like any other RE, must be a public company that holds an AFSL authorising it to operate a scheme.²⁷⁵

A TRE has the same general powers to operate a scheme, as given under the Corporations Act and the constitution of the scheme, as any other RE of the scheme.²⁷⁶ A TRE may also seek to become the new RE, provided it continues to meet the AFSL requirements.²⁷⁷

5.6.2 The eligibility criteria

There are various views on whether the eligibility criteria for being a TRE should be adjusted.

One view is that to require that a TRE hold an AFSL that has the relevant authorisation may unduly restrict the classes of suitable persons willing to act as a TRE. One possibility would be to allow registered liquidators, or even any entity or individual, to act as a TRE, if approved by the court.²⁷⁸ In considering whether to appoint a person that does not hold an appropriate AFSL, the court could ensure that the candidate (whether an individual or corporate entity) was suitable for the role of TRE in the particular circumstances of the scheme.

A contrary view is that the role of a TRE, like any other RE, is to operate the scheme, albeit on a temporary basis. Arguably, a TRE should be subject to the same licensing requirements as any other RE.

²⁷⁴ Section 6.10.3.

²⁷⁵ ss 601FA, 601FK.

²⁷⁶ s 601FB.

²⁷⁷ s 601FQ(3).

²⁷⁸ The Turnbull Report recommended that potential TREs should include official liquidators: rec 3.

Issue

Should the eligibility criteria for being a TRE be amended and, if so, in what way and for what reason?

5.6.3 Submissions

Some respondents supported amending the criteria for eligibility to be a TRE, to include registered liquidators or to allow the court to appoint anyone it considers appropriate.²⁷⁹ Other submissions considered that the current criteria should be maintained, as they reflect skills that an RE should have.²⁸⁰

5.6.4 CAMAC position

The SLE Proposal does not affect this matter.

The court should have the power to appoint as a TRE anyone it considers appropriate in the circumstances, including a registered liquidator or other individual. However, this potentially broader category should only apply to the role of TRE. Anyone (including a TRE) seeking to become a replacement RE should be subject to the AFSL requirements applicable to all REs.

5.7 Outstanding obligations and liabilities of the outgoing RE**5.7.1 Current position**

Any move to widen the pool of candidates to be appointed as a TRE, while it may be beneficial, does not deal with a central reason for the unwillingness of eligible entities to undertake that role, namely that, under the current legal framework, an RE acts as principal in operating a scheme and that, by virtue of s 601FS, a TRE, upon appointment, generally becomes liable for the outstanding obligations and liabilities, as well as acquiring the rights, of any former RE as operator of the scheme. An RE is personally liable for

²⁷⁹ Clarendon Lawyers, Alan Jessup, Property Council of Australia, ASIC, IPA, AAR.
²⁸⁰ Primary Securities Ltd, McMahon Clarke Legal, The Trust Company, Henry Davis York, McCullough Robertson, Property Funds Association.

agreements it enters into as operator of a scheme except where the counterparty has agreed to have only limited recourse rights.

As stated in *Huntley Management Limited v Timbercorp Securities Limited*,²⁸¹ the effect of the current legislative structure for schemes is that:

Once a right, obligation or liability of the corporation that was the former responsible entity or a document to which it was party, can be seen to have the character of being “in relation to the scheme”, it is novated to the new responsible entity by force of ss 601FS and 601FT.

A TRE is a new RE for this purpose.²⁸²

A rationale behind the transfer of liabilities and obligations of an RE under s 601FS is to protect those scheme creditors who have rights of recovery against the personal assets of the RE under agreements entered into with the RE as operator of the scheme.²⁸³ These claims of counterparties should not be extinguished or reduced merely through change of an RE.²⁸⁴ However, a TRE may find itself in debt if its indemnity rights against the property of the scheme are insufficient to cover the obligations and liabilities that it has inherited. An entity may therefore be cautious about agreeing to become a TRE until these matters are assessed through due diligence. That entity could review the register of agreements and the register of scheme property (if those registers are introduced²⁸⁵) to determine the extent of personal liability for the RE under those agreements and the available scheme property to meet that liability.

There can also be considerable uncertainty about what rights and liabilities remain with the former RE, rather than being

²⁸¹ [2010] FCA 576 at [69].

²⁸² The definition of ‘responsible entity’ in s 9 makes specific reference to the TRE. See also the reference to the TRE in s 601FJ.

²⁸³ A counterparty to the RE as principal would have rights of recovery against the personal assets of the RE unless it agreed to have only limited recourse rights. See further Sections 2.3.1 and 2.3.3 of this report.

²⁸⁴ ASIC has indicated that it will not exercise its powers under s 601QA to grant a new RE an exemption for the effect of s 601FS. In *BOSI Security Services Ltd v ANZ Banking Group* [2011] VSC 255, one of the proposed replacement REs had unsuccessfully sought from ASIC an exemption under s 601QA from the operation of s 601FS.

²⁸⁵ See Sections 4.3.4 and 4.4.3 of this report.

transferred,²⁸⁶ with consequences both for the TRE and external parties. As observed in *Stacks Managed Investments Ltd*:²⁸⁷

The effect of [s 601FS(2)(d)] is that the former responsible entity is discharged from its liability to a creditor unless it “could not have been indemnified out of the scheme property if it had remained the scheme’s responsible entity”. ... the section appears to mean that the creditor will not know whether he should sue the former responsible entity or the new responsible entity for his debt, unless he can determine whether the former responsible entity is entitled to an indemnity. A court will not be able to determine which entity is liable for the debt without resolving the question whether it was properly incurred by the former responsible entity, and the new responsible entity has to make the same assessment.

5.7.2 Policy options

Any move to review the current law under s 601FS concerning the transfer of liabilities and obligations upon the appointment of a TRE needs to strike a balance between protecting the interests of creditors of the scheme and recognising that, without some protection from personal liability, suitable entities may be reluctant to come forward when a TRE is being sought.

The policy options outlined below have been developed within the current legal framework whereby an RE acts as the principal in agreements forming part of the scheme and, in consequence, incurs personal obligations and liabilities to the counterparty under those agreements (as well as having rights) except where a counterparty has agreed to have only limited recourse rights. Those policy options deal only with the position of a TRE. They are not intended to apply to the appointment of a new RE, which would remain subject to the effect of s 601FS.

Under the SLE Proposal, an RE would only act as agent for the MIS, in effect making s 601FS (and s 601FT) redundant in relation to those agreements (as an agent does not incur the obligations and liabilities of its principal) and therefore irrelevant where a TRE or new RE is appointed.

²⁸⁶ See s 601FS(2).

²⁸⁷ [2005] NSWSC 753 at [15].

Option 1 Election by the TRE

Under this policy option, the TRE could elect, either before appointment or within a certain time thereafter, whether to be bound by all or some of the outstanding obligations and other liabilities of the outgoing RE.

A TRE might elect to be bound where it considers that there is sufficient scheme property to cover the obligation or liability and to do so would be in the ongoing interests of the scheme. Where the TRE elects not to be bound by a particular agreement of the former RE, the counterparty would still have remedies against that former RE (which would retain its indemnity rights against the property of the scheme in relation to that agreement).

A possible difficulty with the application of this option is the time needed by a TRE to make an informed election.

Option 2 Limited liability of incoming TRE

This policy option would impose personal liability on an incoming TRE (with indemnity rights against scheme property) only for:

- obligations and liabilities incurred by the TRE itself in agreements it entered into as operator of the scheme (which would be reduced to the extent that counterparties to those agreements agreed to have only limited recourse rights), with indemnity rights against scheme property
- pre-existing personal obligations and liabilities of the former RE, up to the value of the scheme property still available to the TRE after satisfaction of the indemnity rights of the TRE in operating the scheme.

The TRE's indemnity rights against scheme property would have priority over other claims, including any indemnity claim by the former RE.

Obligations and liabilities incurred by the TRE. The personal liability of the TRE for obligations and liabilities that it incurs in that capacity may assist the continuation of the scheme during the interim period by providing comfort to counterparties of the TRE

about the payment of their debts.²⁸⁸ A TRE would have indemnity rights against the scheme property for such obligations and liabilities, in the same manner as all REs. The TRE would itself have to meet any shortfall where its indemnity rights were insufficient to cover the obligations and liabilities it incurred.

In some instances, an external party may be prepared to enter into an agreement with the TRE only if that party's outstanding debts are paid beforehand. If the TRE's indemnity rights are insufficient to cover these outstanding debts, a question arises about the viability of the scheme. This may be an instance where the most appropriate next step is for the scheme to go into external administration (see chapters 6 and 7).

Obligations and liabilities of a former RE. The TRE would be personally liable only to the extent that there was sufficient scheme property available to the TRE to cover those obligations and liabilities. This would ensure that a TRE would not have to cover a deficiency in assets left by the outgoing RE.

Pre-existing creditors would retain the right of recovery against the former RE for any outstanding amounts (with the former RE maintaining its indemnity rights against the property of the scheme for those amounts, but postponed to the indemnity rights of the TRE). The residual right of creditors against the former RE would, in effect, mean that an RE could not avoid liability as operator of the scheme simply through the appointment of a TRE. It would eliminate any incentive for an RE to seek appointment of a TRE for that purpose.

Option 3 Court power

Currently, in appointing a TRE, the court has the power to make any further orders 'that it considers necessary'.²⁸⁹

There is uncertainty about the ambit of the court's discretion under this power. On one view, a court may interpret this power more

²⁸⁸ Cf the personal liability of the administrator of a company under ss 443A, 443B, 443BA.

²⁸⁹ s 601FP(2).

narrowly than, say, its broad power to ‘make any orders it considers appropriate’ for the winding up of an unregistered scheme.²⁹⁰

A more broadly stated power may permit the court, where it appoints a TRE, to adjust the obligations and liabilities between the outgoing RE and the TRE if the court considers this to be appropriate. The court could tailor these matters to the circumstances of the particular scheme, with a view to giving some protection to scheme creditors, while not creating too great a disincentive for any suitable entity to agree to act as a TRE. However, having the court adjust obligations and liabilities where it considers this to be ‘appropriate’ may take time, which might delay the appointment of a TRE (who may be unwilling to consent to becoming a TRE until these matters are settled).

Option 4 Moratorium

A further policy option would be a mandatory moratorium on the enforcement against the TRE of pre-existing obligations and liabilities, either during the period of a TRE (up to three months, unless extended by the court) or some other prescribed or court-determined time. Those obligations and liabilities would remain with the former RE (although frozen during the TRE period), to be transferred to any new RE (replacing the TRE), once appointed.

A moratorium would protect a TRE. However, the ostensible purpose of appointing a TRE is to maintain a viable scheme, which should not need a moratorium (which is more applicable to an entity in financial stress). A moratorium may also place the solvency of some creditors in jeopardy.

²⁹⁰ s 601EE(2).

Issue

What, if any, changes should be made to the current provisions concerning the transfer of obligations and liabilities of the outgoing RE to the TRE, and for what reasons?

- Option 1: election by the TRE
- Option 2: limited liability of the TRE (only for (i) obligations and liabilities incurred by the TRE in that role and (ii) pre-existing obligations and liabilities to the value of scheme property after satisfaction of the obligations and liabilities under (i))
- Option 3: court power
- Option 4: moratorium on the enforcement of pre-existing obligations and liabilities

5.7.3 Submissions

No respondents supported Option 1.

Various respondents supported Option 2 (or Option 3 in combination with Option 2), arguing, for instance, that imposing personal liability on a TRE under the current law is unduly burdensome and that Option 2 may make acting as a TRE more palatable.²⁹¹

There was support for a grace period from pre-existing liabilities (Option 4), as a means, for instance, to achieve an optimum balance of interests.²⁹² Another respondent proposed a power for ASIC to determine the terms of the appointment of a TRE.²⁹³

5.7.4 CAMAC position***If the SLE Proposal is adopted***

The SLE Proposal is intended to make s 601FS (and s 601FT) redundant, thereby avoiding the need for any of the policy options.

²⁹¹ ASIC, G Bigmore QC, S Hopper and M Kennedy, Henry Davis York, IPA, Alan Jessup, AAR, Primary Securities Ltd.

²⁹² McMahon Clarke Legal, McCullough Robertson, Property Council of Australia, The Trust Company, Clarendon Lawyers, Primary Securities Ltd.

²⁹³ Baker & McKenzie.

The rights, obligations and liabilities under agreements lawfully entered into by an RE as agent of the MIS, or where the ‘indoor management rule’ applies, would remain with the MIS (as the principal to those agreements), with counterparties having direct rights of action against the property of the scheme held by the MIS. The RE would incur no personal obligations or liabilities pursuant to those agreements in those circumstances, and therefore there would be no obligations or liabilities that would need to be transferred to a TRE or new RE.

Where an RE acted beyond its agency powers and the indoor management rule did not apply, only that RE would be personally liable to the counterparty. That personal liability would not transfer to a TRE or new RE.

If an RE, under an additional arrangement as operator of the scheme, undertook personal liability in some respect, that undertaking should only bind that RE, not a TRE or new RE.²⁹⁴

If the SLE Proposal is not adopted

From one perspective, persons dealing with an RE as operator of a scheme should not have their rights affected by a change of RE. At the same time, it may be detrimental to all affected parties, including scheme members and counterparties generally, if a potentially viable scheme has to be placed in liquidation through failure to attract a TRE in consequence of the disincentive that s 601FS creates for undertaking that role.

Taking these competing matters into account, CAMAC prefers Option 2, namely that a TRE is personally liable only for:

- obligations and liabilities that the TRE itself has incurred in that role, with indemnity rights against scheme property, and
- pre-existing obligations and liabilities, limited to the value of scheme property, after satisfaction of the indemnity rights of the TRE in operating the scheme.

²⁹⁴ See further Section 3.4 of this report.

General power of the court

Whether or not the SLE Proposal is adopted, s 601FP(2) should be amended to give the court a power to make further orders ‘that it considers appropriate’ on the appointment of a TRE or during the period that the scheme is operated by the TRE. This broader formulation of the court’s power is intended to provide a means for the court to deal with the specific, and sometimes competing, considerations and factors that can arise where a TRE to a scheme is being sought, or following the appointment of a TRE.

5.8 Matters covered in the transfer of obligations and liabilities

5.8.1 The issue

As discussed above, any entity considering whether to become a TRE (or new RE) under the current legislative structure for schemes must take into account the consequences of s 601FS regarding the transfer to it of any outstanding obligations and liabilities, as well as rights, of any former RE.

In some instances, what is transferred pursuant to s 601FS, and the related deeming provision, s 601FT, can become a matter of uncertainty or dispute. The courts have considered the ambit of these sections on a number of occasions.

In one case, the Court considered whether these sections, combined with the provision stating that the RE ‘holds scheme property on trust for scheme members’,²⁹⁵ caused incoming REs to ‘acquire property that is subject to a charge’.²⁹⁶ The Court observed that:

Sections 601FS(1) and 601FT(1) are drafted in a particularly economical way. They appear intended to cause an incoming responsible entity to step into the shoes of its predecessor Yet nowhere does one find in those two sections any reference to property. There is a reference to “rights”, being rights “in relation to the scheme”, and there can be no doubt that certain “rights” (although not all) are property. The sections do not seem to effect a form of statutory vesting or

²⁹⁵ s 601FC(2).

²⁹⁶ Former s 264(1) of the Corporations Act, now repealed.

assignment of property generally in such a way that the incoming responsible entity “acquires property that is subject to a charge” (as mentioned in s 264) except, perhaps, to the extent that the subject matter of the charge is a species of property which clearly involves no more than a “right”. An example might be the kind of property involved in a charge made registrable by s 262(1)(f) referring to “a charge on a book debt”. A debt as a chose in action falls quite comfortably within the concept of “right”. But even then, there is a question whether a chose in action forming part of the assets of a scheme is a right “in relation to the scheme”. These last words are perhaps intended to cover only rights vis à vis parties such as members of the scheme, being rights arising from or forming part of the matrix of legal relationships making up the scheme, including rights derived from the scheme’s constitutional documents.²⁹⁷

In a subsequent decision,²⁹⁸ the Court made a number of general observations about the ambit of ss 601FS and 601FT:

It is vital that the words “rights, obligations and liabilities” in Div 3 of Pt 5C.2 be given a broad construction so as to achieve the evident legislative purpose of facilitating an immediate and seamless change of the responsible entity of a scheme whenever ASIC records the new entity’s name in its record of a registered scheme.

[The defendant] argued that the words “in relation to the scheme” in s 601FS(1) covered only rights arising from or forming part of the matrix of legal relationships making up the scheme, including those derived from its constitutional documents. It suggested that those words should not be given too broad a reach and that s 601FT(1), because it worked with s 601FS(1), was implicitly confined to documents concerning the scheme.

I reject that argument. The expression “in relation to” is of wide and general import and should not be read down in the absence of some compelling reason to do so: *Fountain v Alexander* [1982] HCA 16; (1982) 150 CLR 615 at 629 per Mason J. In *Syncap Management (Rural) Australia Ltd v Lyford* [2004] FCA 1352; (2004) 51 ACSR 223 at [46] RD Nicholson J held that “in relation to” as used in

²⁹⁷ *Investa Properties Ltd* [2001] NSWSC 1089 at [11].

²⁹⁸ *Huntley Management Ltd v Timbercorp Securities Ltd* [2010] FCA 576 at [45]-[50]. See also *Syncap Management (Rural) Australia Ltd v Lyford* [2004] FCA 1352 at [41] ff, and *Primary RE Limited v Great Southern Property Holdings Limited (recs & mgrs apptd) (in liq)* [2011] VSC 242 at [166] ff.

s 601FS(1) was an expression of wide import and signified no more than some relationship or connection. As Lindgren J noted, however, the rights, obligations and liabilities of the former responsible entity to which each of ss 601FS(1) and 601FT(1) apply, are impliedly limited to those capable of having an ongoing operation after the change in responsible entity: *Re Huntley Management Ltd; Australian Olive Holdings Pty Ltd v Huntley Management Ltd* (2009) 76 ACSR 256 at [85].

Ordinarily, the scheme would give the responsible entity a legal, and possibly a larger, right to hold scheme property, such as land, in its name. But, by force of ss 601FJ, 601FS(1) and 601FT(1) that right necessarily passes to the new responsible entity on a change becoming effective. In most cases one could expect that control and ownership of scheme property finds its ultimate source in the scheme constitution. Ordinarily, that will identify the basis on which scheme property is held by the responsible entity.

I am of opinion that ss 601FS(1) and 601FT(1) create a means of ensuring that rights to hold, and rights “in relation to”, scheme property pass to and vest in the new responsible entity. This is because ss 601FJ, 601FS(1) and 601FT(1) cause all rights of the former responsible entity “in relation to the scheme” to pass to the new one once changed: cf *City Pacific Ltd (in liq) v Ballandean Investments Pty Ltd* [2010] QCA 113 at [23], [26], per Holmes JA with whom McMurdo P and Chesterman JA agreed and *Capelli v Shepard* [2010] VSCA 2; 264 ALR 167 at [143], [148] per Dodds-Streeton and Mandie JJA and Byrne AJA; *Treecorp Australia Ltd (in liq) v Dwyer* [2009] FCA 278; (2009) 175 FCR 373 at [46], [48] per Gordon J. Likewise, those sections novate obligations and liabilities of the former responsible entity “in relation to scheme property” in the new responsible entity. The language of those provisions suggests that the Parliament had novation, not merely assignment, in mind: *Olsson v Dyson* [1969] HCA 3; (1969) 120 CLR 365 at 388-391 per Windeyer J especially at 388; see too *Goodridge v Macquarie Bank Ltd* [2010] FCA 67; (2010) 265 ALR 170 at [106]-[114] where I discussed the distinction between novation and assignment in contract.

Here, the statutory scheme in Div 3 of Ch 5C.2 is clearly intended to apply to a change of, and effect a transfer between, responsible entities in all situations so as to ensure that the incoming one has the fullest and most effective control of the whole of the scheme and scheme property at the instant that s 601FJ gives effect to the change. This will be achieved by giving a purposive and broad construction to

the expression “in relation to the scheme” in applying ss 601FS and 601FT.

Another case queried the extent to which rights under a validly terminated agreement are transferred to a new RE.²⁹⁹

Issue

What, if any, amendments are needed to clarify the operation of ss 601FS and 601FT, and for what reason?

5.8.2 Submissions

A number of submissions observed that ss 601FS and 601FT can have unintended consequences, such as automatically activating change of ownership default provisions concerning scheme property. Various proposals were put forward to overcome these unintended effects, including an express provision that, upon appointment of a TRE or a new RE, scheme property automatically vests in, and becomes property of, the TRE or new RE, without that constituting any transfer of property from the outgoing RE.³⁰⁰ Another submission raised matters concerning property law.³⁰¹

5.8.3 CAMAC position

If the SLE Proposal is adopted

Under the SLE Proposal, issues concerning the interpretation and application of ss 601FS and 601FT would no longer arise for

²⁹⁹ *Primary RE Limited v Great Southern Property Holdings Limited (recs & mgrs apptd) (in liq)* [2011] VSC 242 at [178]-[179].

³⁰⁰ Freehills, Clarendon Lawyers, Alan Jessup, Baker & McKenzie, IPA, AAR, Primary Securities Ltd.

³⁰¹ The submission from G Bigmore QC, S Hopper and M Kennedy raised the question whether s 601FS permits a TRE or new RE to seek relief against forfeiture of a lease that was terminated during the period that the scheme was operated by a former RE. The submission referred to *Primary RE Limited v Great Southern Property Holdings Limited (recs & mgrs apptd) (in liq) & Ors* [2011] VSC 242, which held that this right to seek relief provided for under s 146 of the *Property Law Act 1958* (Vic) arises at the time a lease is terminated and is not capable of being assigned. Applying that approach, a new RE cannot seek relief to revive a previously terminated lease. The submission argued that an inability of a TRE or new RE to seek relief could impede the possibility of reconstructing an otherwise viable scheme. CAMAC considers that this submission raises matters concerning property law legislation.

agreements that form part of the scheme. The RE (including a TRE or a new RE) would act as agent in entering into those agreements, with the rights, obligations and liabilities under them remaining with the MIS as the principal (or with the members if the RE was acting as their agent). Any personal agreements that the RE might enter into in the course of operating the scheme would only bind the parties. Sections 601FS and 601FT would be redundant.

If the SLE Proposal is not adopted

It is necessary to prevent ss 601FS and 601FT from having unintended consequences, even if merely by default, such as automatically triggering pre-emptive rights or default events. The legislation could state that a transfer of property rights, obligations or liabilities under these provisions from an RE to a TRE or new RE shall not, of itself, be taken to be a change of ownership of that property for the purposes of triggering pre-emptive rights or default events.

It would still be open to parties to specify particular circumstances when pre-emptive rights or default events would occur, such as if a named RE is replaced, or is replaced without the consent of the counterparty. This report elsewhere deals with such arrangements.³⁰²

5.9 Duties of the TRE

5.9.1 Current position

A TRE, its officers and its employees have statutory duties in operating the scheme, in the same manner as any other RE and its personnel.³⁰³

Particularly where the appointment of a TRE is required as a matter of urgency, it may be difficult for an entity to determine the implications of the statutory and other duties that would arise if it agreed to take on that role.

What may be required of a TRE to comply with its duties in relation to a particular scheme can be affected by the conduct of the former RE. For instance, an RE and its officers have a duty to maintain, and

³⁰² Section 5.3.3.

³⁰³ ss 601FC-601FE.

comply with, the compliance plan of the scheme.³⁰⁴ The former RE may have failed in various respects to fulfil this obligation. The TRE may then be faced with the task of implementing steps to ensure compliance with the plan. Similar issues may arise with other obligations of an RE or a TRE, including to ensure that the scheme's constitution meets certain statutory requirements,³⁰⁵ or to consider whether civil action should be taken against the former RE.³⁰⁶

The magnitude of the task facing the TRE in fulfilling various duties may be in direct proportion to the level of default of the former RE in relation to these matters.³⁰⁷

A TRE is an interim body appointed by the court to operate a scheme until a replacement RE can be found or the decision is reached to have the scheme placed in external administration. Arguably, it should not be incumbent on a TRE, in that interim period, to undertake a full review of the scheme to discern what needs to be done to ensure full compliance by the TRE with its duties as the operator of the scheme and to ensure that the TRE does not attract personal liability for any of its officers.³⁰⁸

Not all the statutory duties on a TRE may call for adjustment. For instance, a TRE, like any other RE, has a duty to report to ASIC any breach of the Corporations Act that relates to the scheme and that has had, or is likely to have, a materially adverse effect on the interests of members.³⁰⁹ That reporting obligation arises for an RE 'as soon as practicable after it becomes aware of the breach'.³¹⁰ Arguably, this awareness requirement would not impose an investigative obligation on the TRE to review the conduct of the former RE for the purpose of checking for irregularities.

³⁰⁴ The RE: s 601FC(1)(g), (h). Officers of the RE: s 601FD(1)(f)(iv).

³⁰⁵ s 601FC(1)(f).

³⁰⁶ An RE is civilly liable to members for loss or damage that they suffer because of conduct of the RE that contravenes the managed investment provisions: s 601MA. One of the roles of a replacement RE (and its officers), as part of the duty to act in the best interests of members (ss 601FC(1)(c), 601FD(1)(c)), may be to consider whether an action against the former RE on these grounds is called for.

³⁰⁷ See further D Walter, 'Managed investment schemes' (2011) 23(1) *Australian Insolvency Journal* 12.

³⁰⁸ See, for instance, the potential liability under s 197.

³⁰⁹ Compare the reporting obligation on corporate voluntary administrators under s 438D(1), and on liquidators under s 533(1).

³¹⁰ s 601FC(1)(l).

One policy option to avoid the duties of a TRE, its officers and its employees becoming unduly burdensome would be to give the court the power to adjust those duties, either at the time of appointment of the TRE or at any subsequent time, taking into account the particular circumstances of the scheme. The court, in appointing a TRE, has the power to make such further orders as it considers 'necessary'.³¹¹ A question is whether this power would suffice to allow the court to make suitable orders concerning these duties, or whether a broader court power to cover these matters would be appropriate.

Issue

What, if any, changes should be made to the current provisions concerning the duties and consequential liabilities of the TRE and its officers and employees, and for what reasons?

5.9.2 Submissions

Respondents proposed various ways to adjust the duties of a TRE to the particular circumstances of the scheme, including a restricted statement of duties, a grace period where a TRE is not personally liable while it evaluates the scheme, or a more general power for the court to make appropriate orders.³¹²

5.9.3 CAMAC position

The SLE Proposal does not affect this matter.

There may be considerable disincentives to assuming the position of TRE in consequence of the duties for the TRE, its officers and its employees, which arise immediately upon appointment. It may be very difficult in some cases accurately to assess the implications of these duties before accepting the appointment. Also, the uncertainty for the prospective TRE may be exacerbated by the possibility of liabilities immediately coming into effect with that appointment, through past and unresolved compliance failures of the former RE.

³¹¹ s 601FP(2).

³¹² Henry Davis York, McCullough Robertson, Clarendon Lawyers, ASIC, IPA, Baker & McKenzie, AAR, Financial Services Council, Primary Securities Ltd, Property Funds Association.

The legislation should contain a more explicit statement of the duties of a TRE as manager of a scheme, as well as the duties of its officers and employees. The duties of these parties should be commensurate with the temporary nature of the office of TRE and should not include an obligation to rectify breaches or failures to comply that occurred before the TRE took office.

To provide further flexibility, the court should be given a general power to adjust those duties and liabilities to particular circumstances. This could be achieved by amending s 601FP(2) to give the court a general power to make any further orders ‘that it considers appropriate’ on the appointment of a TRE or during the period that the scheme is operated by the TRE.

5.10 Remuneration of the TRE

5.10.1 The issue

One consideration for a prospective TRE would be the likelihood of receiving remuneration (including expenses), for services to be provided. An entity may be reluctant to become a TRE unless there is some certainty that adequate funds are available for this purpose, free of competing claims by other parties.

In making an order to appoint a TRE, the court has the power to make any further orders that ‘it considers necessary’.³¹³

There is a question whether this power is wide enough to cover matters concerning the remuneration of the TRE. One possibility, to add greater certainty, is to give the court an explicit power to make orders setting out the remuneration arrangements for a TRE.³¹⁴

Issue

What, if any, statutory or other provision should be made in regard to the remuneration of the TRE, and for what reasons?

³¹³ s 601FP(2).

³¹⁴ cf s 473(10) for companies.

5.10.2 Submissions

There was support in submissions for the court having the power to determine the remuneration of the TRE, either generally or in the event that the scheme members fail to agree on the amount.³¹⁵ It was also suggested that priority be given to any unpaid TRE fees in any subsequent winding up of the scheme.³¹⁶

5.10.3 CAMAC position

The SLE Proposal does not affect this matter.

The court should have a general power to determine the remuneration of a TRE of any scheme. The court could use that power when appointing the TRE or at any later time upon application. Priority should attach to any TRE fees in any subsequent winding up of the scheme.³¹⁷

5.11 The role of the TRE regarding the future of a scheme

5.11.1 Current position

A TRE is intended to be an interim body only. One of its key functions is to take steps for the appointment of a new RE. For this purpose, the TRE is required to call at least one meeting of scheme members to vote on any proposed new RE (if there is an eligible candidate) as soon as practicable and, in any event, within three months of becoming the TRE (subject to the court granting an extension of this period).³¹⁸ A TRE may itself offer to become the new RE.³¹⁹

Where a meeting of scheme members is not held within the requisite period (as there may be no suitable entity willing to become the new RE), or any meeting within that period has not resulted in a new RE being chosen by members, the TRE must apply to the court for the

³¹⁵ ASIC, Baker & McKenzie, IPA, AAR, Clarendon Lawyers, Primary Securities Ltd, Alan Jessup, Financial Services Council.

³¹⁶ Clarendon Lawyers, Financial Services Council.

³¹⁷ See further Section 7.5.5 of this report.

³¹⁸ s 601FQ(1), (2).

³¹⁹ This right is recognised in s 601FQ(3).

winding up of the scheme.³²⁰ ASIC or any scheme member may make this winding up application if the TRE fails to do so.³²¹

A TRE, like any RE, can seek to wind up the scheme if it considers that the purpose of the scheme has been, or cannot be, accomplished.³²² Similarly, a TRE may apply to the court for the winding up of the scheme on the ‘just and equitable’ ground.³²³

5.11.2 Issues

Conflict of interest

During the course of operating a scheme, a TRE may consider offering to become the new RE.

The decision on the appointment of a new RE rests with the scheme members. There is specific statutory recognition of the right of members to appoint the TRE as the new RE, if the TRE is willing.³²⁴ However, given the central role of the TRE in the process for appointing a new RE, there is the potential for a conflict of interest between the desire of a TRE to be chosen as the new RE and its role in seeking expressions of interest from other parties who may, in effect, compete with the TRE for the position of new RE.

Placing a scheme in voluntary administration

The proposals discussed in chapter 6 to introduce procedures for the voluntary administration of a scheme also have implications for the TRE of a scheme that is under financial stress but is nevertheless potentially viable. These questions arise:

- should the TRE have a role in appointing an administrator to the scheme
- if so, should the TRE be able to make that appointment on its own initiative, or only have the right to apply to the court for such an appointment

³²⁰ s 601FQ(5).

³²¹ s 601FQ(5).

³²² s 601NC. See further Section 7.2.2 of this report.

³²³ s 601ND(1)(a), (2)(a). See further Section 7.2.3 of this report.

³²⁴ s 601FQ(3).

- if the TRE has a unilateral right to appoint an administrator to the scheme:
 - should the exercise of that power be subject to some legislative constraints, for instance that the TRE ‘thinks that the scheme is insolvent, or is likely to become insolvent at some future time’³²⁵
 - should there be a prohibition on the TRE appointing itself as the scheme administrator (assuming it is eligible to so act) without creditor or court approval?³²⁶

Assisting an external administrator

In the event of an external administrator (whether an administrator or a liquidator) being appointed to the scheme, the appointee will most likely seek assistance from officers and employees of the TRE.

In the absence of some right for the TRE to recover its costs in assisting the administrator or liquidator, entities may be reluctant to undertake the role of TRE where there is a real doubt about the ongoing viability of the scheme. However, any priority given to the TRE for its costs in assisting an external administrator would also impinge on the recovery rights of other parties with a financial interest in the assets of the scheme. In particular, there is an issue concerning the respective priorities to be accorded to the costs incurred by the TRE and those of any external administrator seeking the assistance of the TRE.

Issues

Are any changes regarding the role of the TRE in the future of a scheme necessary or beneficial and, if so, for what reasons?

In this regard, what, if any, legislative initiatives should there be, and for what reasons, in regard to:

- a possible conflict of interest faced by the TRE
- the interaction between the TRE provisions and a procedure for voluntary administration of a scheme (if introduced)

³²⁵ cf s 436B(1) for companies.

³²⁶ cf s 436B(2) for companies.

- a TRE providing assistance to an external administrator?

5.11.3 Submissions

Conflict of interest

One view in submissions was that, as the TRE owes fiduciary duties to scheme members, there is no need for further prescription.³²⁷

Another view was that a TRE should be obliged to take all reasonable steps to facilitate the consideration by members of alternative REs, including assisting any potential replacement REs in conducting due diligence.³²⁸

Placing a scheme in voluntary administration

Various respondents supported the TRE having a power to appoint an administrator, for instance where the TRE forms the view that the scheme is insolvent, or is likely to become insolvent at some future time.³²⁹

Assisting an external administrator

There was support for the TRE having an obligation to assist any external administrator of the scheme.³³⁰

5.11.4 CAMAC position

The SLE Proposal does not affect this matter.

Conflict of interest

A TRE that is seeking to become the new RE may be reluctant to assist an entity that it considers to be a competitor for this position. To protect the interests of scheme members, a TRE should have an obligation to provide reasonable assistance to a prospective new RE in conducting due diligence:

- upon request from at least 5% of scheme members, or

³²⁷ Baker & McKenzie.

³²⁸ Clarendon Lawyers.

³²⁹ Clarendon Lawyers, IPA, The Trust Company, McCullough Robertson. Alan Jessup, Property Funds Association, and Baker & McKenzie preferred no change.

³³⁰ McCullough Robertson.

- when directed by court order.

Placing a scheme in voluntary administration

A TRE should have the same unilateral power as an RE to put a scheme into VA, namely where it considers that:

- the scheme is insolvent or is likely to become insolvent at some future time, or
- the purpose of the scheme cannot be accomplished in its current form.³³¹

This power would allow for the situation where a TRE forms the view that, given the level of financial stress of the scheme, it is not appropriate to place the scheme under the management of a new RE, but it is also premature to appoint a liquidator.

A TRE who is a registered liquidator³³² should not have the unilateral right to appoint himself or herself, or an associate, as the administrator, but could seek court approval for such an appointment.³³³

Assisting an external administrator

A TRE should have an obligation to assist an external administrator (whether an administrator or a liquidator), with payment to the TRE being an expense of the VA and having a priority in any winding up of the scheme.³³⁴

³³¹ See further Section 6.3.3 of this report.

³³² See Section 5.6.4 of this report where CAMAC recommends that the court should have the power to appoint as a TRE anyone it considers appropriate, including a registered liquidator.

³³³ cf s 436B(2).

³³⁴ See further Section 7.5.5 of this report.

6 Restructuring a financially stressed scheme

This chapter discusses the question in the terms of reference whether an RE can restructure a financially viable scheme and whether voluntary administration procedures, comparable to the procedures that currently apply to companies, should be introduced for schemes.

6.1 Overview

This chapter deals with schemes in financial stress that possibly could be restored to financial viability. It considers whether this goal might be achieved by the introduction into the scheme provisions of a voluntary administration (VA) procedure, based on Part 5.3A of the Corporations Act, which applies to companies. A VA procedure for schemes was recommended in the ALRC/CASAC report, but was not implemented when the current provisions in Chapter 5C of the Corporations Act were introduced.

This chapter:

- describes the nature of a corporate VA (Section 6.2)
- examines how a scheme VA might be constructed under the current legal framework (Section 6.3)
- examines how a scheme VA might be constructed under the SLE Proposal (Section 6.4)
- examines some key implementation issues relevant to a scheme VA (Sections 6.5-6.10). In other respects concerning the VA process, a scheme VA would follow the model of a corporate VA.

CAMAC recommends the introduction of a VA procedure for schemes, as part of implementing the SLE Proposal. It also supports a VA procedure for schemes if the SLE Proposal is not adopted, but

notes that this procedure would necessarily be more complex under the current legal framework.

6.2 Nature of a corporate VA

The VA provisions currently apply to companies. An RE, being a public company,³³⁵ can be placed in VA.

The principal purpose of a corporate VA under Part 5.3A is to provide for the business, property and affairs of a company that is insolvent, or is likely to become insolvent at some future time, to be administered in a way that either maximises the chances of the company, or as much as possible of its business, continuing in existence or, if that is not possible, results in a better return for the company's creditors and members than would result from its immediate winding up.³³⁶ A company is insolvent if it cannot pay all its debts as and when they become due and payable (the cash flow test).³³⁷

The VA provisions are facilitative, not mandatory. Where the directors of a company form the opinion that the company is insolvent, or is likely to become insolvent at some future time, they may initiate the VA process by appointing an administrator, who must be a registered liquidator.³³⁸ A liquidator or holder of a security over all or substantially all the company's property may also place a company in VA in some circumstances.³³⁹ None of these parties require court approval to appoint the administrator. The ability to act quickly when a company is in financial stress is seen to be an important advantage of the VA procedure. Company directors may be motivated to act to avoid the possibility of being personally liable for the insolvent trading of the company if it continued its operations without going into VA.³⁴⁰

³³⁵ s 601FA.

³³⁶ The objects of voluntary administration are set out in s 435A.

³³⁷ s 95A.

³³⁸ s 436A.

³³⁹ ss 436B, 436C.

³⁴⁰ ss 588G (director's duty to prevent insolvent trading by the company) and 588H (the defences).

From its commencement, a VA imposes a general moratorium on the rights of creditors of the company³⁴¹ in order to permit the administrator to assess the potential viability of the company and to convene a creditors' meeting to consider whether:

- to enter into a deed of company arrangement (DOCA), binding the company and its creditors and involving some form of adjustment of creditors' rights, that would allow the company to continue to operate, rather than to be wound up, or
- to have the company wound up, or
- the administration should end, and the company continue in operation as before the VA.³⁴²

Where a DOCA is agreed by resolution of creditors, it is common to appoint the administrator as the deed administrator. If the creditors resolve that the company go into liquidation, the usual practice is for the administrator to become the liquidator of the company.

6.3 Scheme VAs under the current legal framework

6.3.1 Role of a scheme VA procedure

A scheme, not being a company, cannot currently be placed in VA.

The present procedures for dealing with a financially stressed scheme can vary, depending on whether a voluntary arrangement is entered into with its creditors, or a receiver³⁴³ or liquidator is appointed. An alternative approach is to attempt to include a scheme in the external administration of its RE.

³⁴¹ An exception applies to substantial security holders, who may choose, within a specified time period, whether to enforce their security interest: s 441A, definition of 'decision period' in s 9.

³⁴² s 439A.

³⁴³ A receiver is not an officer of the RE (*Owen, in the matter of RiverCity Motorway Pty Limited (Administrators Appointed) (Receivers and Managers Appointed) v Madden (No 3)* [2012] FCA 313) and is therefore not subject to the duties of an officer of the RE in the exercise of receivership powers.

Introducing a facilitative VA procedure, specifically designed for schemes, may assist a scheme to recover financial viability, where possible, and where there is sufficient support from affected parties.

6.3.2 Factors in designing a VA procedure

Introducing a VA procedure for schemes within the current legal framework is not a straightforward exercise, given that the structural and liability arrangements for schemes can be more complex than for companies.

Insolvency of a scheme

The key concept in the initiation of a corporate VA is whether the company is insolvent, or is likely to become insolvent. A scheme is not a legal entity and therefore technically cannot become insolvent, as it does not incur debts in its own right. However, the courts have sought to develop the concept of an insolvent scheme. For instance, in *Capelli v Shepard*,³⁴⁴ the Court observed that:

a scheme may colloquially be characterised as insolvent in the sense that ... the liabilities referable to it cannot be satisfied as they fall due from its income or readily realisable assets.³⁴⁵

CAMAC proposes that a definition of an insolvent scheme be included in the legislation. Adopting a commercial cash flow perspective, a scheme should be defined as insolvent if:

the scheme property is insufficient to meet all the claims that can be made against that property as and when those claims become due and payable.

Other factors

While useful as a general concept, the concept of an insolvent scheme does not suffice as a basis for developing a VA regime for schemes under the current legal framework. Such a regime also needs to take into account that counterparties to agreements entered into by an RE as operator of a scheme can look to the personal assets

³⁴⁴ [2010] VSCA 2 at [93].

³⁴⁵ Other cases that use the concept of insolvency in relation to managed investment schemes are *Re Orchard Aginvest Ltd* [2008] QSC 2, *Re PWL; ex parte PWL Ltd (formerly Palandri Wines Ltd) (administrators appointed) [No 2]* [2008] WASC 232 at [44], *Rubicon Asset Management Limited* [2009] NSWSC 1068 at [21], [25].

of the RE for payment (regardless of the state of solvency of the scheme) unless they have only limited recourse rights.

For counterparties with recovery rights against the personal assets of the RE, the state of solvency of that RE is an important, if not a key, factor in whether they would be willing to compromise their rights in a VA of a scheme. This means that under the current legal framework a VA for a scheme cannot be considered without taking into account the financial state of its RE and the claims that can be made against the personal assets of the RE. This situation may be further complicated by whether the RE is a sole-function or a multi-function RE.

Accordingly, a VA procedure for schemes under the current legal framework needs to be considered in two distinct contexts:

- when the RE is solvent
- when the RE is insolvent.

6.3.3 Scheme VA where the RE is solvent

Currently, an RE is personally liable for all the liabilities and obligations arising from agreements into which it enters as operator of a scheme, unless the counterparty has only limited recourse rights. To avoid its own insolvency, an RE must pay all debts for which it is personally liable, as and when they become due and payable. This obligation applies whether or not the RE has sufficient funds available to it from its indemnity rights against scheme property to cover those debts.

An RE of a scheme that is, or is likely to become, insolvent has several options presently open to it. It may:

- choose to continue operating the scheme for some time (with the RE paying debts for which it is personally liable from its personal assets, and not seeking to recover those funds, or its costs and remuneration entitlements, from scheme property), while seeking to restore the scheme to financial viability. This

may include the RE selling some scheme assets to generate revenue³⁴⁶

- seek to have the scheme wound up.³⁴⁷ The adequacy of the current provisions concerning an RE placing a scheme in liquidation is considered in chapter 7 of this report. However, the winding up of the scheme does not relieve the RE of any outstanding personal liabilities it has incurred as operator of that scheme.

Alternatively, an RE may seek to restructure the scheme in some way, with a view to making it viable in the longer term. The RE may, depending on the circumstances:

- seek to amend the scheme constitution in some manner (which would require approval of scheme members unless the amendment would not adversely affect their rights³⁴⁸)
- seek to enter into some form of informal ‘workout’ with all relevant stakeholders (see below under ‘effect on creditors’ and ‘role of other affected parties’). Any such arrangement would only bind those parties who had expressly so agreed.

A further option to assist a financially stressed scheme in these circumstances would be to introduce a legislative VA procedure for schemes. It would differ from an informal ‘workout’ in that it would allow a majority of stakeholders to bind a minority under a scheme deed (analogous to a DOCA).

³⁴⁶ In selling assets of the scheme, the RE and its officers must comply with their statutory duties (ss 601FC, 601FD) and any relevant terms of the scheme constitution (s 601GA).

³⁴⁷ An RE can seek to have a scheme wound up on the basis that the scheme’s purpose ‘cannot be accomplished’: s 601NC(1)(b). Scheme members have rights to be informed and to meet to consider the winding up proposal: s 601NC(2). Members may agree to have the scheme wound up or, alternatively, may seek to have the scheme continue under a new RE if a suitable entity is willing to undertake that role: s 601FM.

³⁴⁸ s 601GC(1). The relevant principles concerning the exercise of this power by the RE are set out in *ING Funds Management Ltd v ANZ Nominees Ltd* [2009] NSWSC 404, and summarised in *Re Elders Forestry Management Ltd* [2012] VSC 287 at [53]-[58].

If a scheme VA were to adopt a similar approach to a corporate VA, the RE or the holder of a security over all, or substantially all, the scheme property, would have power to initiate the scheme VA.

However, a VA procedure for schemes where the RE is solvent would differ from a corporate VA procedure in various key ways:

- *grounds for commencement*: the grounds for a solvent RE to initiate a scheme VA would need to reflect the various reasons why that process might be appropriate:
 - the scheme is insolvent or is likely to become insolvent at some future time. This insolvency ground, which focuses on the adequacy of scheme property to cover all the claims that can be made against that property, as and when those claims become due and payable, would be particularly relevant to the position of parties with only limited recourse rights, or
 - the purpose of the scheme ‘cannot be accomplished in its current form’. This more general ground may have particular application to common enterprise schemes, which may have little scheme property. It contemplates the possibility of using the VA procedure to adjust various rights of affected parties, to allow the scheme to continue with a view to its purpose being accomplished.³⁴⁹

The grounds for a person holding a security over the whole, or substantially the whole, of the property of a scheme to initiate a VA of that scheme should be that the security interest has become enforceable³⁵⁰

- *position of the RE*: the administrator of the scheme would assume the power to operate that scheme, without becoming its RE. The existing RE, being solvent, would not itself be placed in VA and could continue its other affairs, which may include operating other schemes

³⁴⁹ For instance, an agribusiness common enterprise scheme may need to be restructured where its crops are growing more slowly than expected due to prolonged adverse weather conditions. Existing contractual arrangements involving the RE, scheme members and third parties may not have allowed for this longer period for conducting the scheme.

³⁵⁰ cf s 436C.

- *effect of the moratorium*: placing a scheme in VA would freeze all relevant agreements, including those imposing personal obligations and liabilities on the RE in its capacity as operator of the scheme,³⁵¹ even though the RE is solvent and retains its capacity to operate other schemes. This issue does not arise in a corporate VA, which only affects the obligations and liabilities of the insolvent company itself
- *effect on creditors*: the effect of a proposed scheme deed on the legal rights and entitlements of persons with recovery rights against the personal assets of the RE may be sufficiently different from the effect on persons with only limited recourse rights that consideration may need to be given to introducing class voting in this form of scheme VA.³⁵² Corporate VAs generally do not allow for class voting³⁵³
- *role of other affected parties*: the structure of some schemes, particularly various common enterprise schemes, may involve scheme members, and sometimes external parties, having proprietary or other interests which are utilised as part of the enterprise. To be effective, a scheme deed may need to deal with these interests, thereby expanding the categories of involved parties and having implications for the voting arrangements on a deed.³⁵⁴ These matters do not arise in a corporate VA
- *effect of a deed*: any compromise or other arrangement under a scheme deed could reduce the personal obligations and liabilities incurred by the RE in its capacity as operator of that scheme, even though the RE is solvent. This issue does not arise in a corporate VA, which only affects the obligations and liabilities of the insolvent company itself.

It would be a matter for relevant stakeholders whether to agree to a proposed scheme deed. For instance, some creditors may have long-term contracts involving the scheme, which they might prefer

³⁵¹ See further Section 6.5 of this report.

³⁵² The CAMAC report *Members' schemes of arrangement* (2009), at Section 5.1, discusses the class voting tests in the context of s 411 schemes of arrangement.

³⁵³ The exception is that, where a DOCA proposal put to the creditors of a company will have the effect of varying the priority entitlements of eligible employee creditors under ss 556, 560 and 561, there is a requirement for a separate meeting, statement and resolution by those employee creditors: s 444DA.

³⁵⁴ See further Section 6.6 of this report.

to be continued, even if it means postponing or reducing their rights in some manner, including any rights they may have against a solvent RE.

One factor that parties might consider in deciding whether to vote for a scheme deed is whether they might be better placed if the scheme were wound up instead. For instance, if the voidable transaction provisions that apply to companies in liquidation³⁵⁵ were also applied to the winding up of schemes, it may be possible to recover certain funds paid from scheme property, with a view to their more equitable distribution to scheme creditors, including parties with limited recourse rights. Such transactions would not be able to be challenged if the scheme entered a deed. These parties could look to the report of the administrator³⁵⁶ for details of prior payments from scheme property in deciding how to vote on the future of the scheme.

6.3.4 Scheme VA where the RE is insolvent

An RE, being a public company, can be placed in VA. The directors of an RE can resolve to put the RE into VA if they are of the opinion that the RE is insolvent or is likely to become insolvent at some future time.³⁵⁷ Alternatively, an insolvent RE may be placed in liquidation.

Sole-function RE

The financial viability of a sole-function RE is directly linked to the performance of the scheme that it operates. For instance, a sole-function RE may be insolvent if there is insufficient scheme property to cover the personal obligations and liabilities that the RE has incurred in operating the scheme and for which it has lawful indemnity rights against that property.

In some instances, a sole-function RE may be insolvent, though its scheme remains solvent. This could occur, for instance, where the RE is unable to exercise indemnity rights against scheme property through some improper conduct on its part and this lack of recovery

³⁵⁵ Pt 5.7B Div 2.

³⁵⁶ cf s 439A(4) for companies.

³⁵⁷ s 436A.

undermines the revenue base of the RE. In those circumstances, a TRE or a new RE might be appointed to operate the scheme.³⁵⁸

Where the insolvency of a sole-function RE arises from the insolvency of its scheme, the external administration of the RE would encompass the affairs of the scheme that it has operated, as this is its only business. This would obviate the need for a separate VA or winding up procedure for the scheme other than in exceptional circumstances, such as where the RE has indemnity claims against scheme property that could be disputed. The administrator of the RE should administer the scheme as part of the external administration of the RE, except where the administrator determines that in the circumstances it would be preferable to have separate VAs. Any interested party should have standing to apply to the court to challenge the existence of a joint or separate administration.

Multi-function RE

A multi-function RE may become insolvent for various reasons, which may or may not reflect on the viability of a particular scheme that it operates. For instance:

- the RE may become insolvent from its activities unrelated to any scheme that it operates, and/or
- the RE may become insolvent from its operation of one or more schemes.

A multi-function RE that is at risk of insolvency could seek to retire from its role as RE of one or more viable schemes.³⁵⁹ Alternatively, members of a scheme who are aware that the RE is financially stressed may seek to appoint a new RE, or have the court appoint a TRE.³⁶⁰ Having a TRE appointed, or appointing a new RE, would remove the scheme from the consequences of any subsequent insolvency of its former RE.

Where an insolvent multi-function RE goes into external administration, the administrator or liquidator has control of its

³⁵⁸ See chapter 5.

³⁵⁹ s 601FL.

³⁶⁰ See chapter 5.

‘affairs’. There is some difference of view in the case law about whether the affairs of an RE, for the purpose of its external administration, include the schemes that it operates.³⁶¹ If it were placed beyond doubt that the ‘affairs’ of an RE have this broader application, this would permit the affairs of all schemes still being operated by a multi-function RE at the time the RE goes into external administration to be included in the external administration of the RE, at least initially, with a view to a determination of:

- which, if any, schemes are viable in their own right and should no longer be part of the external administration of the RE
- how to deal with financially stressed schemes, namely:
 - which, if any, of those schemes should be included in any VA of the RE
 - which, if any, of those schemes could benefit from a separate scheme VA
 - which, if any, of those schemes should be wound up. The issue of a separate winding up procedure for schemes is discussed in chapter 7.

Viable schemes

For a viable scheme (but where the RE is insolvent), the most suitable course would be to appoint a TRE or a new RE, thereby removing the scheme from the external administration of its former RE.³⁶² If the insolvent RE is promptly replaced, the period of disruption to the operation of this viable scheme in consequence of the RE going into external administration would be minimal.

Subsequent to appointment, a TRE may form the view that, given the level of financial stress of the scheme or that the purpose of the

³⁶¹ If the RE goes into external administration, one line of judicial authority suggests that the affairs of a scheme being managed by the RE could, in principle, be dealt with under a VA of the RE, given the wide definition of ‘affairs of a body corporate’ in s 53: *Silvia, in the matter of FEA Plantations Ltd (Administrators Appointed)* [2010] FCA 468. Another line of authority expresses doubts about whether the VA of an RE would properly extend to any scheme that it operates: *Owen, in the matter of RiverCity Motorway Pty Limited (Administrators Appointed) (Receivers and Managers Appointed) v Madden (No 3)* [2012] FCA 313 at [7].

³⁶² This process is dealt with in chapter 5 of this report.

scheme cannot be accomplished in its current form, it is not appropriate to place the scheme under the management of a new RE, but it is also premature to appoint a liquidator. In those circumstances, the TRE should have the same power as a solvent RE to place the scheme in VA (see Section 6.3.3).³⁶³

Financially stressed schemes

In some circumstances, there may be good reason for having a separate VA for one or more financially stressed schemes that are still being operated by a multi-function RE when it goes into external administration.

In other circumstances, to include the affairs of some schemes in the VA of their REs could pose particular difficulties, including:

- it may place the RE administrator in a position of conflict between the duty of the RE (and therefore the administrator of the RE, as an officer of the RE³⁶⁴) to act in the best interests of scheme members³⁶⁵ and the general law duty of the administrator of the RE to act in the interests of the creditors of the RE
- it may prove unworkable, unduly complex or time-consuming to devise a DOCA for the RE that, in addition to covering the circumstances of the RE, satisfactorily deals with the particular circumstances of one or more schemes that the RE operates, taking into account the possible differences in the level of financial stress of different schemes³⁶⁶
- it may be anomalous if some creditors of the RE could vote on that part of a proposed DOCA for the RE that deals with a particular scheme in which those creditors have no direct

³⁶³ See also Section 5.11.4 of this report, where CAMAC recommends that, to avoid a possible conflict of interest, a TRE who is otherwise eligible (a registered liquidator) should not have the unilateral right to appoint himself or herself, or an associate, as the scheme administrator, but could seek court approval for such an appointment.

³⁶⁴ See paragraph (d) of the definition of 'officer of a corporation' in s 9.

³⁶⁵ s 601FD(1)(c).

³⁶⁶ As observed in the submission from G Bigmore QC, S Hopper and M Kennedy, one source of concern for investors in some agribusiness schemes has been the perception that the external administrator appointed to the various insolvent REs of these schemes may have considered the viability of all schemes together and not have adequately considered the solvency of each scheme separately.

financial interest. With one exception (which would not be relevant in the context of a scheme VA),³⁶⁷ the corporate VA provisions generally do not allow for separate votes of different classes of creditors with different types of interests and rights³⁶⁸

- an administrator of the RE may not have an automatic right to draw on scheme property to pay the costs for any work that he or she may do in investigating the affairs of that scheme, given that the administrator's appointment is to the RE, not to the scheme, and the RE holds scheme property on trust for scheme members.³⁶⁹

The grounds for the external administrator of the RE, or the court (on application by ASIC, a scheme member or any other party whose interests are affected), to initiate a separate VA for a scheme that had been operated by the insolvent RE could be the same as those proposed for where the RE is solvent, namely that:

- the scheme is insolvent or
- the purpose of the scheme cannot be accomplished in its current form³⁷⁰

together with an additional element to take into account that the RE is in external administration, namely that:

- the interests of affected parties would be better served by a separate scheme VA, rather than its affairs being included in the VA of the RE.

In addition, a party that is entitled to enforce a security interest over the whole, or substantially the whole, of the property of the scheme

³⁶⁷ If a DOCA proposal put to the creditors of a company will have the effect of varying the priority entitlements of eligible employee creditors under ss 556, 560 and 561, there is a requirement for a separate meeting, statement and resolution by those employee creditors: s 444DA. A scheme, not being a separate legal entity, would not have employees.

³⁶⁸ Creditors in the VA of an RE may include creditors whose claims relate to the operation by the RE of a particular scheme as well as creditors of the RE whose claims relate to other activities of the RE (including other schemes operated by the RE). All creditors of the RE would vote as one class on any proposed DOCA.

³⁶⁹ s 601FC(2).

³⁷⁰ See Section 6.3.3.

should be entitled to commence a separate VA of that scheme if the security has become enforceable.³⁷¹

In some cases, the most efficient and effective course, particularly where the affairs of the scheme form the principal or only part of the affairs of the RE, may be to have the same person as administrator of the RE and of the scheme. In other circumstances, the better course may be to have different persons conduct the VAs of the scheme and of the RE. It would be inappropriate to place an outright prohibition on the same person conducting both VAs. Rather, as in a corporate VA, the person initiating the VA should determine in the first instance who is the administrator, with the right of parties at the first meeting to change the administrator.³⁷²

Under this approach, a scheme deed (or deeds) could be proposed that:

- relates to a particular scheme only
- is to be voted on only by the relevant stakeholders of that scheme, and
- if approved, is binding on those stakeholders (the terms of a deed may be conditional: for instance, they may be subject to the approval of deeds for other affected schemes).

The definitive register of scheme agreements and the definitive register of scheme property (as proposed in chapter 4 of this report) would indicate what agreements relate to that particular scheme, who are the stakeholders of that scheme and what property is involved. If a deed (or deeds) for a particular scheme is approved, the scheme could continue under its terms, which may require the appointment of a TRE as an interim measure while a new RE is sought.

6.3.5 CAMAC position

A VA regime for schemes could assist in restoring the viability of financially stressed schemes or provide an orderly means for their

³⁷¹ cf s 436C.

³⁷² cf s 436E(4).

administration prior to their winding up. The concept of a scheme VA also received in-principle support from respondents.³⁷³

In practice, VAs for schemes may more often be employed for common enterprise schemes, but this should not preclude their use, if beneficial, for pooled schemes.

If the SLE Proposal is adopted

CAMAC prefers VAs for schemes being introduced within the context of the SLE Proposal, as described in Section 6.4. A VA procedure for schemes under the SLE Proposal would be considerably less complex than a VA procedure under the current legal framework.

If the SLE Proposal is not adopted

A VA regime for schemes under the current legal framework would need to distinguish between situations where an RE is solvent and where it is insolvent. It would also need to deal with the situation where a scheme is being operated by a TRE.

Solvent RE

CAMAC supports a VA procedure for schemes where the RE is solvent, as described in Section 6.3.3. As indicated in that Section, a scheme VA in these circumstances would have various elements that materially distinguish it from a corporate VA.

Insolvent RE

CAMAC supports a VA procedure for schemes where the RE is insolvent, as described in Section 6.3.4. As indicated in that Section, where an RE goes into external administration, each scheme being operated by the RE would form part of that external administration, with a view to determining which schemes, if any, should be separately dealt with, including through their own VA.

TRE

CAMAC elsewhere recommends that a TRE should have the right to place a scheme in VA.³⁷⁴

³⁷³ IPA, ASIC, Ashurst Australia, McCullough Robertson, The Trust Company, Property Council of Australia, Property Funds Association, McMahon Clarke Legal, Clarendon Lawyers. Some other respondents raised concerns about possible complexity and cost.

Implementation issues

The CAMAC positions on various key implementation issues that apply to any form of scheme VA, whether under the current legal framework or under the SLE Proposal, are set out in Sections 6.5-6.10.

6.4 Scheme VAs under the SLE Proposal

6.4.1 Outline

Compared with the difficulties of designing scheme VAs within the current legal framework, as described in Section 6.3 above, scheme VAs under the SLE Proposal would be relatively straightforward.

Definition of insolvency

Under the proposed definition, a scheme would be insolvent where:

the scheme property is insufficient to meet the claims that can be made against that property as and when those claims become due and payable.³⁷⁵

Separation from affairs of the RE

Counterparties to agreements entered into by the RE as operator of a scheme would have direct rights against scheme property. They would have no rights against the personal assets of the RE, unless the parties had so agreed, which would involve a separate private liability.³⁷⁶ Equally, placing an RE in external administration would not affect the property of any scheme that it operates, which would be held by the MIS. In consequence, the state of solvency of an RE of a scheme, and whether the RE is a sole-function RE or a multi-function RE, while having to be taken into account under the current legal framework (see Section 6.3), are irrelevant under the SLE Proposal.

³⁷⁴ See Section 5.11.4 of this report.

³⁷⁵ cf s 95A.

³⁷⁶ See Section 3.4 of this report.

Initiating a scheme VA

The grounds for initiating a scheme VA (comparable to the grounds for VAs under the current legal framework) could be that:

- the scheme is, or is likely to become, insolvent, or
- the purpose of the scheme cannot be accomplished in its current form.

If a scheme VA were to adopt a similar approach to a corporate VA, the RE or a person entitled to enforce a security interest over all, or substantially all, the scheme property, would have power to initiate the VA. The proposal that the RE and its directors be liable for any insolvent trading by the scheme³⁷⁷ would act as a strong incentive for them to place an insolvent scheme in VA. Likewise, the RE, as operator of a scheme, would be best placed to determine whether the purpose of the scheme cannot be accomplished in its current form. CAMAC elsewhere recommends that a TRE also have the right to place a scheme in VA.³⁷⁸

Effect of a scheme VA

The appointment of an administrator of a scheme would transfer the power to operate the scheme from the RE to the administrator. The future of the RE would depend upon whether it has other functions to perform (for instance, operating other ongoing schemes) and its own financial viability.

While under the SLE Proposal the insolvency of an RE cannot result in a scheme that it operates going into insolvency, the opposite could happen. The insolvency of a scheme could lead to the insolvency of its RE, particularly where the RE depends on remuneration received from that scheme for its own financial viability. In some cases, there may be a practical benefit in the same person being the administrator of the scheme and of the RE. The identity of the administrator should be left for determination under each VA process, without placing an outright prohibition on the same person conducting both VAs.

³⁷⁷ Section 3.6 of this report.

³⁷⁸ See Section 5.11.4 of this report.

An alternative to placing a scheme in VA would be to have it wound up. The adequacy of the current powers to initiate the winding up process, and the need for a scheme winding up procedure, under the SLE Proposal, are discussed in chapter 7.

6.4.2 CAMAC position

Preference for scheme VAs under the SLE Proposal

CAMAC prefers the VA procedure for schemes under the SLE Proposal, as outlined in Section 6.4.1. That procedure would be relatively straightforward, compared with what may be required under the current legal framework. It would provide an opportunity to rehabilitate a potentially viable scheme where there was sufficient support from stakeholders.

Implementation issues

The CAMAC positions on various key implementation issues that apply to any form of scheme VA, whether under the current legal framework or under the SLE Proposal, are set out in Sections 6.5-6.10.

6.5 Ambit of a scheme VA

6.5.1 Wide moratorium

In a corporate VA, a moratorium applies, from the time of appointment of the administrator, to all actions or proceedings by creditors of the company. Its purpose is to give the administrator time to prepare advice to the creditors on the future of the company. Shareholders have no right to be consulted in this process or to vote on a DOCA.

As with a company, the appointment of an administrator to a scheme would initiate a moratorium. The experience with some recent failures of common enterprise schemes points to the need to give the moratorium a wide ambit, to:

- stabilise all aspects of a scheme while the likelihood of its financial rehabilitation and future viability, and the steps necessary to achieve this, can be determined and voted on in an orderly manner, and

- to overcome attempts at rehabilitation being frustrated by individuals seeking to assert claims in other forums and thereby interfering with this process.

CAMAC considers that, to be effective, a scheme moratorium should freeze any actions, proceedings or assertions of rights related to the affairs of the scheme, by the following classes of persons:

- *the RE*, in relation to its indemnity rights as operator of the scheme
- *scheme members holding proprietary or contractual rights*, in relation to rights, obligations or liabilities that they have incurred in that capacity³⁷⁹
- *external parties* in relation to any interest that they may have in connection with the scheme or any claim that they may have against:
 - the RE in its capacity as operator of the scheme
 - scheme members in that capacity,³⁸⁰ or
 - scheme property³⁸¹

subject to an exemption for a substantial security holder (see below)

³⁷⁹ Some common enterprise schemes, particularly in the agribusiness sector, have involved the scheme members having a form of property interest in ‘allotments’ of land used for the particular agricultural purposes of the scheme, with those members having certain property or contractual rights to the products of that land (for instance, trees or crops). The intention was that proceeds from the sale of products, after deduction of costs and fees charged by scheme operators, be pooled and distributed to investors in proportion to the number of allotments of land they hold.

³⁸⁰ For instance, property owned by a scheme member and not forming property of the scheme could be provided as security to an external party for some aspect of the operations of the scheme, with the consent of the scheme member.

³⁸¹ One respondent, Clarendons Lawyers, considered that the VA should also bind external parties who have an interest in the subject matter of the scheme or who have claims against the RE as operator of the scheme, or against scheme members or against property that may be scheme property. In the experience of that respondent, actions such as the termination of head leases have had irreparable effects on the ability of a potentially viable scheme to be restructured and to continue.

- *members in their capacity as members* in relation to any redemption, voting, or other procedural rights given to them in the legislation or pursuant to constituent documents of the scheme.³⁸²

CAMAC elsewhere recommends the introduction of an agreements register³⁸³ and a scheme property register.³⁸⁴ Under those proposals, the administrator could treat the agreements register as definitive of all the agreements that form part of the scheme, for the purpose of the moratorium. Likewise, the administrator could treat the register of scheme property as definitive of scheme property, for the purpose of the moratorium.

The moratorium could operate for a stipulated period (subject to extensions being granted by the court³⁸⁵) to provide an opportunity for the scheme administrator to investigate the affairs of the scheme and to prepare proposals for consideration by affected parties, where appropriate. Any time for doing acts under agreements subject to the moratorium would not run during that period.³⁸⁶

6.5.2 Exemption for substantial security holder

In a corporate VA, a party holding a security over the whole, or substantially the whole, of the property of a company may choose to enforce the security interest within a certain period, thereby

³⁸² These rights, and any other procedural rights provided for under a scheme constitution, are comparable to shareholder rights, which are frozen in a corporate VA, with shareholders generally having no rights to participate in the VA: see s 600H for exceptions to this general proposition, introduced by the *Corporations Amendment (Sons of Gwalia) Act 2010*.

³⁸³ Section 4.3.4 of this report.

³⁸⁴ Section 4.4.3 of this report.

³⁸⁵ cf s 439A(5), (6) for companies.

³⁸⁶ cf s 451D.

exempting that security interest from the moratorium.³⁸⁷ Other secured creditors are bound by the initial moratorium, but all secured creditors have the right to choose not to be bound by the DOCA.³⁸⁸

On one view, the VA of a scheme may be easier to implement if a complete moratorium could be imposed from the outset, with no 'opt-out' capacity for any substantial security holder at that stage. Instead, that type of secured creditor, like all other secured creditors would be protected by the right to choose not to be bound by any scheme deed.

CAMAC considers that it is difficult, in principle, to justify a different enforcement regime for a secured creditor depending upon whether that party is dealing with a company or a scheme. Failing to give secured creditors in a scheme VA comparable rights in the moratorium period to those that they have in a corporate VA may create a disincentive for them to deal with a scheme, or lead to them imposing more burdensome terms.

6.5.3 Administrator's power to grant exemption from moratorium

In a corporate VA, the administrator may agree to certain arrangements, otherwise subject to the moratorium, being enforceable, where this is necessary to protect the company's property.³⁸⁹ Likewise, a scheme administrator should have a power to determine that agreements coming within the scheme moratorium be kept on foot in order for the scheme to survive. An example would be an agreement between an RE or a scheme member and an

³⁸⁷ A party that holds a security over the whole, or substantially the whole, of the property of a company that goes into VA can enforce that security interest within a 13 business day decision period after the appointment of an administrator: s 441A, definition of 'decision period' in s 9. Property of a scheme may be used as security for funding to support the operations of the scheme, with, for instance, the secured party having the right to appoint a receiver to the property in the event of default. The ALRC/CASAC approach envisaged the scheme administrator being required to notify his or her appointment to any holder of a substantial security over scheme property: vol 2, draft s 458RA(3), (4) (p 211) (cf s 450A(3), (4) for companies). Upon notification, the secured party would be permitted to enforce the security interest, either itself or through a receiver or other agent, within a specified time: vol 2, draft s 458GA (pp 188-189) (cf s 441A, s 9 definition of 'decision period' for companies).

³⁸⁸ s 444D(2).

³⁸⁹ Part 5.3A Div 6.

external party for that party to tend crops forming a major part of an agribusiness common enterprise scheme. Failure to tend the crops during the moratorium period may lead to the loss of a principal asset of the scheme.

6.6 Scheme deeds

6.6.1 Width of proposed deeds

Given the proposed width of the moratorium (see above), the scheme administrator may propose one or more scheme deeds, which may involve a range of parties, with possibly diverse interests. For instance, a proposed deed or deeds could cover:

- the rights of persons who have dealt with the RE as operator of the scheme
- the rights of persons who have entered into agreements with scheme members
- the proprietary or contractual rights of scheme members or any related rights of external parties.³⁹⁰

A proposed deed might also affect the distribution or other rights that scheme members may have as contributors to the scheme.

³⁹⁰ In *Great Southern Managers Australia Limited (Receivers and Managers appointed) (in liq)* [2009] VSC 557, and in the absence of a scheme VA procedure, the Court considered that it was reasonable to call meetings of scheme members to consider and vote on resolutions intended to effect changes to their agreements as 'growers' without the need to obtain a separate agreement to those changes from each member grower. However, the Court's view depended on the specific terms of the documentation involved, including a power of attorney granted by the member growers when they signed the application form for an interest in the scheme. Furthermore, even the power of attorney would not be sufficient to support the required changes if the scheme member who granted the power had died or revoked the power (at [13]). The Court also acknowledged arguments that the use of the power of attorney for this purpose may not have the desired result, but considered that 'it is by no means clear that such arguments must succeed' (at [18]). A VA for a scheme could overcome the need to rely on such grounds to adjust rights.

Issues

If the VA of a scheme is to involve classes other than scheme creditors:

- in relation to any voting on any proposed scheme deed:
 - how should the classes entitled to vote on the scheme deed be determined? For instance, should it be left to the administrator to determine those classes, taking into account the extent to which the deed affects their interests
 - where classes vote on the deed, should they be entitled to vote on the whole deed or only that part that affects their interests
 - should the approval of all voting classes be required for the scheme deed to come into force, or should the deed apply to those classes that have approved it
- in what circumstances, if any, should a scheme deed be able to override the rights of scheme members under the scheme constitution or impose new obligations on those members?

6.6.2 Submissions

One view in submissions was that the administrator acting alone should determine whether voting on a scheme deed should be done by classes and who should be in each class.³⁹¹ A contrary view was that the administrator should require court approval to determine classes.³⁹²

One respondent considered that classes voting on a deed should vote on the whole deed,³⁹³ while another respondent was of the view that classes should vote only on that part of a deed that affected their interests.³⁹⁴

³⁹¹ McCullough Robertson (though this respondent only favoured the VA of a scheme involving creditors and was therefore only referring to the administrator determining different classes of creditors), Property Funds Association.

³⁹² IPA, Clarendon Lawyers.

³⁹³ IPA.

³⁹⁴ Clarendon Lawyers.

One submission considered that the approval of all voting classes should be required for the scheme deed to come into force.³⁹⁵ Another submission considered that it should be permissible to implement a deed in relation to the classes that approve it.³⁹⁶

One respondent³⁹⁷ proposed a provision to prevent members from being treated as creditors in respect of debts related to their investment, referring, by way of comparison, to s 563A of the Corporations Act, introduced by the *Corporations Amendment (Sons of Gwalia) Act 2010*.

Another respondent³⁹⁸ considered that a scheme deed should not be able to override the rights of members under the constitution of the scheme or impose new obligations on those members unless members approve the relevant aspects of the scheme deed by resolutions at a members' meeting by the same majority as would be required to effect those changes in the absence of a deed.

6.6.3 CAMAC position

A corporate VA involves creditors voting on a single proposed DOCA.³⁹⁹ However, taking into account the proposed width of the moratorium in a scheme VA, and the possible complexity of some common enterprise schemes, an administrator should have the flexibility to prepare one or more draft scheme deeds, which may covers all or only some matters relevant to the future of the scheme, and which may involve the interests of all, or only some, of the parties affected by the moratorium.

In the first instance, it should be a matter for the administrator to decide, in relation to any proposed scheme deed, who should have voting rights, whether there should be two or more voting classes, and who should be included in each class. The administrator could be guided by the principles applicable to secured and unsecured creditors in corporate VAs and the voting class principles applied in a members' or creditors' scheme of arrangement.⁴⁰⁰ The

³⁹⁵ IPA.

³⁹⁶ Clarendon Lawyers.

³⁹⁷ IPA.

³⁹⁸ Clarendon Lawyers.

³⁹⁹ s 439C.

⁴⁰⁰ See further the CAMAC report *Members' schemes of arrangement* (December 2009), Section 5.1.

administrator should have the right to seek court directions on any aspect of the matter, including class voting.

Parties whose interests would be affected by a decision of the administrator concerning voting should have standing to appear on any application to the court by the administrator, or otherwise make their own court application. The court should have a broad power to make any modifications to the proposed voting arrangements (including class voting) that are required in particular circumstances.

Approval of a scheme deed by a stipulated majority should bind the minority of those who were entitled to vote.⁴⁰¹ Affected parties should have the right to challenge a scheme deed on the ground that it is unfairly prejudicial to, or discriminatory against, them.⁴⁰²

The approval process for any scheme deed should, however, be subject to the right of secured creditors to choose not to be bound by any deed affecting their interests, as in a corporate VA.⁴⁰³

Parties should be entitled to make their approval of a deed conditional on other matters. For instance, approval may be conditional on approval of other scheme deeds, or scheme members approving certain changes to the scheme constitution, which might include loss of rights, or new obligations, for scheme members. This raises the question whether the current legislative voting rules, such as the requirement for a special resolution of scheme members to change the scheme constitution,⁴⁰⁴ might be relaxed in this context, for instance, by requiring only an ordinary resolution for members to amend the constitution. While any such voting relaxation could assist the VA process, it would also represent a fundamental change to the procedural rights of scheme members, and would require, at a minimum, a provision to prevent the majority of scheme members oppressing other scheme members. Currently, the oppression provisions in Part 2F.1 of the Corporations Act do not apply to schemes. On balance, CAMAC is of the view that the current voting requirements for scheme members to amend the constitution should

⁴⁰¹ cf a corporate VA, where a resolution of creditors requires the support of a majority by number, as well as by value, of creditors: Corp Reg 5.6.21(2), (3).

⁴⁰² cf s 445D(1)(f)(i) for companies. See also s 600A for the court's power where the outcome of a vote has been determined by a related entity.

⁴⁰³ s 444D(2).

⁴⁰⁴ s 601GC.

remain, with these requirements to be taken into account in designing draft scheme deeds.

6.7 Winding up or end of administration

6.7.1 Options with some schemes

In some circumstances, a scheme administrator may propose that the scheme be wound up or, conversely, that the administration come to an end and the scheme continue to operate without a scheme deed.

Issues

If the VA of a scheme is to involve classes other than scheme creditors:

- what should be the voting rules for any proposal that:
 - the scheme be wound up, or
 - the scheme administration end and the scheme continue as before?

6.7.2 Submissions

Some respondents considered that approval of a winding up, or the termination of an administration and continuation of the scheme, should be by a simple majority by number and value for each class.⁴⁰⁵ One of those respondents took the view that, if a resolution accepting a deed proposal or ending the administration is not passed, the default position should be the winding up of the scheme.

Another respondent considered that the voting requirements and voting rules should be left to the administrator.⁴⁰⁶

6.7.3 CAMAC position

The same general approach concerning discontinuance of a VA, or winding up, should apply to schemes and companies, with all

⁴⁰⁵ IPA, Clarendon Lawyers.

⁴⁰⁶ McCullough Robertson. That respondent favoured the VA of a scheme involving creditors only.

involved parties voting on the resolution.⁴⁰⁷ However, parties involved in a scheme VA may have differing, sometimes conflicting, interests. The situation may arise where parties cannot agree on one or more scheme deeds, but also cannot agree to discontinue the VA or have the scheme wound up.

CAMAC considers that, where a resolution put forward by the administrator to discontinue the VA or wind up the scheme is defeated, the administrator should have standing to approach the court to make an order. Any affected party should be entitled to appear on the application.

6.8 Matters affecting the scheme administrator

6.8.1 Who can be a scheme administrator

Only a registered liquidator can be the administrator of a company or the administrator of a DOCA.⁴⁰⁸

One possibility is to give the court the power to appoint any person it considers suitable to conduct the VA of a scheme, whether or not that person is a registered liquidator or would be eligible to be the RE of the scheme.⁴⁰⁹ This wider category of potential administrators may assist in ensuring that a scheme administrator has any specialist skills needed to conduct the administration of a particular scheme.

A contrary view is that such a court power is unnecessary. In practice, administrators of insolvent companies employ persons with specialist skills to operate the company, or some aspect of it, where necessary.⁴¹⁰ The same approach could be adopted by a scheme administrator.

⁴⁰⁷ For companies, see s 439C.

⁴⁰⁸ s 448B.

⁴⁰⁹ Section 601FA provides that the RE must be a public company holding an AFSL to operate the scheme.

⁴¹⁰ For instance, Principle 13 of the IPA *Code of Professional Practice for Insolvency Practitioners* states: 'When accepting an appointment the Practitioner must ensure that their firm has adequate expertise and resources for the type and size of the Administration, or the capacity to call in that expertise and those resources as needed.'

Issue

In the context of a scheme administration, should there be any change to the current requirement that only a registered liquidator can be an administrator or a deed administrator and, if so, why?

Submissions

Most submissions⁴¹¹ considered that scheme administrators should be limited to registered liquidators. This is consistent with the VA of a company. The administrator can engage any expert assistance as and when required. Also, registered liquidators must have professional indemnity insurance.

One respondent⁴¹² considered that any administrator should be required to have skills and experience commensurate with the size and complexity of, and relevant to, the business of the scheme.

CAMAC position

CAMAC considers that who should be permitted to be an administrator should be consistent between corporate and scheme VAs. On that basis, only registered liquidators should be able to be scheme administrators or scheme deed administrators, as they have the necessary skills and are required to have the appropriate insurances. Where necessary, they can seek expert assistance on particular matters pertaining to the scheme.

6.8.2 Functions, powers and liabilities of the scheme administrator

The willingness of suitable persons to accept the role of scheme administrator may depend in large measure on the powers that they can exercise to fulfil their function, and the potential liability to which they are exposed in that role.

⁴¹¹ IPA, McCullough Robertson, Baker & McKenzie, Clarendon Lawyers, ASIC.

⁴¹² Clarendon Lawyers.

The administrator of a company has control of the company's business, property and affairs and has a range of statutory powers, including:

- to carry on that business and manage that property and those affairs
- to terminate or dispose of all or part of that business
- to dispose of any of that property
- to perform any function, and exercise any power, that the company or any of its officers could perform or exercise if the company were not under administration.⁴¹³

The ALRC/CASAC report proposed that a scheme administrator have similar powers.⁴¹⁴

The ALRC/CASAC approach also proposed that a scheme administrator, in the exercise of those powers, would only be liable for contractual or other liabilities that the administrator incurs while acting in that role. That would cover, for instance, services rendered to the administrator, goods bought or property hired, leased, used or occupied by the administrator or rental payments for property that the administrator intends to continue using.⁴¹⁵ This personal liability of the scheme administrator would protect the interests of the counterparty to any transaction with the scheme administrator and in this way help maintain the operations of the scheme during the administration period.

The ALRC/CASAC approach envisaged the administrator having an indemnity out of the scheme property for the debts he or she lawfully incurred in that role.⁴¹⁶ That indemnity right would take priority over any indemnity rights of the RE over that property.⁴¹⁷

⁴¹³ s 437A.

⁴¹⁴ vol 2, draft s 458CA (p 179).

⁴¹⁵ vol 2, draft ss 458JA, 458JB, 458JC (pp 194-195) (cf ss 443A, 443B, 443BA, 443C for companies).

⁴¹⁶ vol 2, draft s 458JD (p 196) (cf s 443D for companies).

⁴¹⁷ vol 2, draft s 458JE (pp 196-197) (cf s 443E for companies).

Issues

Should a scheme administrator have similar powers to those of the administrator of a company?

For what liabilities, if any, should a scheme administrator be personally liable, and what, if any, rights of indemnity should the administrator have against scheme property?

*Submissions**Functions*

The view was expressed that a key function of an administrator, particularly if administering a common enterprise scheme, would be to put options to the scheme members about the future of the scheme.⁴¹⁸

Powers

There was support for scheme administrators having powers comparable to those of company administrators.⁴¹⁹

Liabilities and indemnity

Several respondents supported scheme administrators having similar liabilities and rights (including the right of indemnity) to those of the administrator of a company.⁴²⁰ One of those respondents⁴²¹ said that the right of indemnity should have priority over any direct claims of pre-appointment unsecured creditors of the scheme.

CAMAC position

It should be made clear that in a scheme VA, the administrator, not the RE, would operate the scheme, with the RE (even if itself under external administration) formally remaining in office, without powers, as every scheme must have an RE.⁴²² This arrangement

⁴¹⁸ ASIC.

⁴¹⁹ ASIC (common enterprise schemes only), IPA, Clarendon Lawyers.

⁴²⁰ ASIC, IPA, McCullough Robertson, Property Funds Association, Clarendon Lawyers.

⁴²¹ IPA.

⁴²² cf s 437C, which suspends the powers of directors and other corporate officers during the period that a company is in voluntary administration. Also, during that period, only the administrator can deal with the company's property: s 437D. The ALRC/CASAC report recommended similar provisions for the VA of a scheme: vol 2, draft ss 458CC, 458CD (pp 179-180).

would also ensure that entry into a scheme VA under the current legal framework would not activate the transfer to the administrator of the obligations and liabilities, as well as rights, that accompanies the replacement of an RE.⁴²³

The functions, powers and liabilities of the administrator of a scheme should be comparable to those of the administrator of a company, subject to the particular additional powers for the administrator in relation to putting forward one or more scheme deeds and determining the voting arrangements on the deed.⁴²⁴ Also, as earlier indicated, an administrator should have the power to exempt particular agreements from the moratorium where the administrator considers that this is necessary to ensure the continuation of the scheme.⁴²⁵

A scheme administrator, in the exercise of his or her functions and powers, should only be liable for contractual or other liabilities that the administrator incurs while acting in that role, with a right of indemnity out of the scheme property for the debts lawfully so incurred. That indemnity right should take priority over any indemnity rights of the RE over scheme property.

6.8.3 Remuneration of the scheme administrator

Under the corporate VA provisions, the remuneration of a company administrator is determined:

- by agreement between the administrator and the committee of creditors (if any); or
- by resolution of the company's creditors; or
- if there is no such agreement or resolution—by the court.⁴²⁶

A similar procedure applies to the determination of the remuneration of a deed administrator.⁴²⁷

⁴²³ Stated another way, the appointment of an administrator would not constitute a change of RE for the purposes of s 601FS.

⁴²⁴ See Section 6.6.3.

⁴²⁵ See Section 6.5.3.

⁴²⁶ s 449E(1). This section incorporates reforms recommended by CAMAC: *Corporate Voluntary Administration* (1998) rec 38, *Rehabilitating large and complex enterprises in financial difficulties* (2004) rec 18.

The remuneration of administrators and deed administrators has priority in a corporate winding up.⁴²⁸

On one view, the legislation could provide a similar procedure for determining the remuneration of a scheme administrator and a scheme deed administrator, with comparable provisions for the priority that this remuneration has on winding up.

Issues

Who should determine the remuneration of a scheme administrator or a scheme deed administrator?

What, if any, classes of persons in addition to the scheme creditors should be involved and in what manner and for what reasons?

What priority provisions should there be for the remuneration of a scheme administrator or a scheme deed administrator if the scheme goes into winding up?

Submissions

Respondents identified various parties who might perform the function of supervising the remuneration of an administrator, including the court,⁴²⁹ scheme creditors (excluding the RE),⁴³⁰ scheme members⁴³¹ and, more generically, whoever is entitled to vote for the deed.⁴³²

Several submissions suggested that the remuneration of a scheme administrator should have the same priority rights as the remuneration of a company administrator.⁴³³

⁴²⁷ s 449E(1A).

⁴²⁸ s 556(1)(a). The winding up priority provisions also apply to payments under a DOCA unless the deed provides expressly to the contrary: s 444A(5), Corp Reg 5.3A.06, Schedule 8A cl 4.

⁴²⁹ ASIC, McCullough Robertson, Baker & McKenzie, Property Funds Association (if the constitution does not provide for sufficient remuneration), Clarendon Lawyers (taking into account the support, or otherwise, for that remuneration from the committee of scheme creditors and/or the committee of scheme members).

⁴³⁰ McCullough Robertson, Baker & McKenzie.

⁴³¹ ASIC.

⁴³² IPA.

⁴³³ IPA, McCullough Robertson, Clarendon Lawyers.

CAMAC position

The remuneration of a scheme administrator or a scheme deed administrator should be determined by simple resolution of those persons whose rights are affected by the moratorium (or by agreement between any committees of these persons and the relevant administrator) or, in the event of failure to agree by resolution, by the court. Approved remuneration should have the same priority rights as in a corporate VA, with a priority arrangement if the scheme goes into winding up.⁴³⁴

6.9 Court powers

6.9.1 Possible court power

The ALRC/CASAC approach envisaged the court having the power, similar to its general discretionary power under s 447A in a corporate VA,⁴³⁵ to make such orders ‘as it thinks appropriate’ about how the scheme administrator provisions are to operate in relation to a particular scheme, on application by various stipulated parties or any other interested person.⁴³⁶

Issue

What powers should the court have in any VA of a scheme, and who should be entitled to apply to the court for this purpose?

6.9.2 Submissions

Submissions supported the ALRC/CASAC approach concerning the court having a power, similar to s 447A for companies, to make such orders as it thinks appropriate about how the VA provisions for a scheme should apply, on application by:

⁴³⁴ See Section 7.5.5 of this report.

⁴³⁵ Section 447A permits a court to make such orders ‘as it thinks appropriate’ about how Part 5.3A is to operate in relation to a particular company whose affairs are being administered under that Part.

⁴³⁶ vol 2, draft s 458NA (pp 204-205) (cf s 447A for companies). G Bigmore & N Hannan, ‘Issues arising out of winding up managed investment schemes’ (2010) 11(3) *Insolvency Law Bulletin* 42 at 44 consider that the introduction of the equivalent of s 447A would assist in taking account of the diversity of industries in which schemes operate.

- the RE/TRE
- a creditor of the RE
- the administrator of the scheme
- ASIC, or
- any other interested party.⁴³⁷

6.9.3 CAMAC position

The powers of the court in relation to the VA of a scheme should include the equivalent of s 447A. That section was a deliberate approach by the legislature to allow the court to assist parties in what was, when Part 5.3A was introduced in 1993, a novel approach to company insolvency and reconstruction. The section has frequently been used by the courts to resolve matters of statutory or procedural detail that would otherwise have impeded a successful corporate VA.

A similar provision would assist the voluntary administration of schemes. The sometimes complex structure of common enterprise schemes, and the difficulties experienced by the courts in trying to deal with the factual and legal circumstances that can arise, support the court having a broad power of this nature in scheme VAs. The administrator or any other interested party (including ASIC or any party whose interests are affected by the moratorium) should have standing to apply to the court to exercise that power.

6.10 Need for an ongoing RE

6.10.1 Replacing the RE

The future of a scheme may depend not only on the outcome of the VA process but also on the willingness and ability of the existing RE to continue in that role or finding a suitable replacement RE.

⁴³⁷ ASIC, IPA, McCullough Robertson, Property Funds Association, Clarendon Lawyers (which also suggested a scheme member and the scheme deed administrator as possible applicants), Baker & McKenzie (the latter submission, however, did not support the introduction of a VA procedure for schemes).

Any entity considering taking on the role of replacement RE would need to undertake due diligence, including to evaluate the financial and commercial circumstances and prospects of the scheme. These matters are further discussed in Section 5.2. The terms of a scheme deed may assist by reducing the obligations and liabilities of a new RE under the current legal framework to manageable proportions. Also, the administrator of the scheme could assist a potential new RE to conduct the necessary due diligence.

Where a scheme deed has been accepted, but the existing RE is no longer able to perform that role⁴³⁸ and no other party is willing to become the RE, the scheme would need to be wound up. One possibility, where a longer time may be necessary to attract a suitable new RE, would be to confer on a scheme or deed administrator, or the court, a power to appoint a TRE to operate the scheme, for some time at least. Any TRE appointed in those circumstances would be in the same position as a TRE appointed to a viable scheme (see further chapter 5).

Issue

In what circumstances, if any, should there be a power to appoint a TRE to operate a scheme in the context of its VA, and who should be able to exercise any such power?

6.10.2 Submissions

There was support for the court having the power to appoint a TRE on the application of the scheme administrator or deed administrator.⁴³⁹

One respondent favoured the deed administrator being able to appoint a TRE to a scheme that is subject to a deed without the need for a court appointment.⁴⁴⁰

⁴³⁸ For instance, one effect of an RE going into insolvency is that it may lose its AFSL, which is a prerequisite to being an RE: s 601FA.

⁴³⁹ McCullough Robertson, Clarendon Lawyers.

⁴⁴⁰ IPA.

6.10.3 CAMAC position

A scheme administrator or a scheme deed administrator would be well placed to see whether it is in the interests of scheme members, or necessary to protect scheme property, that a TRE be appointed to a scheme. Either party should have standing to apply to the court to make that appointment if a suitable person is willing to undertake that role. Issues concerning a TRE are further considered in chapter 5 of this report.

7 Winding up a scheme

This chapter considers the questions in the terms of reference concerning the adequacy of the current provisions regarding the winding up of solvent and insolvent schemes.

7.1 Overview

Part 5C.9 of the Corporations Act sets out who can initiate the winding up of a scheme, and in what circumstances. It envisages a scheme being wound up by its RE in accordance with the terms of the scheme constitution. There is no statutory guidance about the content of the scheme constitution in this regard, other than it must make ‘adequate provision’ for winding up the scheme.⁴⁴¹ There is some recognition of other circumstances that may need to be taken into account, such as where the scheme constitution is inadequate or impracticable⁴⁴² or the RE has ceased to exist or is not properly discharging its obligations in relation to the winding up.⁴⁴³ Beyond that, there is no statutory direction, particularly on the procedures to be followed if the scheme is insolvent.

A possible reason for this lack of legislative guidance is that, when the current scheme provisions were introduced, the focus may still have been on pooled schemes, which tended to lose value if their investments were unprofitable, rather than become insolvent. The extent to which common enterprise schemes would develop as vehicles for conducting business enterprises, with all the commercial and solvency risks that this could entail, may not have been contemplated.

Within this context, this chapter considers issues arising in relation to:

- winding up a solvent scheme (Section 7.2)

⁴⁴¹ s 601GA(1)(d).

⁴⁴² s 601NF(2).

⁴⁴³ s 601NF(1).

- winding up an insolvent scheme that has been in VA (if that procedure is introduced) (Section 7.3)
- winding up an insolvent scheme that has not been in VA (Section 7.4).

It also discusses some key procedural issues where an insolvent scheme is to be wound up separately from its RE (Section 7.5).

7.2 Winding up a solvent scheme

The SLE Proposal does not affect this matter.

7.2.1 Concept of a solvent scheme

A scheme is not a legal entity and therefore technically cannot be solvent or insolvent, as it does not incur debts in its own right. However, applying the insolvency definition adopted in this report,⁴⁴⁴ a scheme would be solvent if the scheme property is sufficient to meet all the claims that can be made against that property as and when those claims become due and payable. A scheme that could not meet this test would be insolvent.

The winding up of a solvent scheme may be less complicated than that of an insolvent scheme, given the absence of outstanding claims on scheme property.

7.2.2 Initiating a solvent winding up without the need for a court application

Current position

Scheme constitution

The constitution of a scheme may set out circumstances where the scheme is to be wound up (for instance, at a specified time, in specified circumstances or on the happening of a specified event). However, any attempt in the scheme constitution to entrench a particular RE by requiring that the scheme be wound up if that entity ceases to be the RE is of no effect.⁴⁴⁵

⁴⁴⁴ See Section 6.3.2.

⁴⁴⁵ s 601NA.

Scheme members

The members of a scheme may, at any time, by extraordinary resolution (which requires that it be passed by at least 50% of the total votes that may be cast by members entitled to vote on the resolution, whether or not cast), direct the RE to wind up the scheme.⁴⁴⁶ The meeting can be called at the request of at least 100 members entitled to vote or members with at least 5% of the total votes.⁴⁴⁷

The RE

An RE may initiate the winding up of a scheme where it considers that the purpose of the scheme ‘has been accomplished or cannot be accomplished’.⁴⁴⁸ To proceed, the RE must first give notice of its intention to the scheme members and ASIC, with:

- an explanation of the proposal to wind up the scheme (including how the purpose of the scheme has been accomplished or why that purpose cannot be accomplished)
- an indication to scheme members of their right to call a meeting of members on this proposal
- a statement that the RE is permitted to wind up the scheme if a meeting of scheme members is not called within 28 days.⁴⁴⁹

The onus is placed on scheme members to request the meeting.⁴⁵⁰ If members call a meeting, the scheme can be wound up only if they pass an extraordinary resolution approving the winding up.⁴⁵¹

An alternative avenue for the RE is to apply to the court to have the scheme wound up on the ‘just and equitable’ ground.⁴⁵²

Also, the RE of a scheme ‘must ensure that the scheme is wound up’ if the members pass a resolution removing the RE but do not, at the

⁴⁴⁶ ss 601NB, 601NE(1)(b) and definition of ‘extraordinary resolution’ in s 9.

⁴⁴⁷ s 252B.

⁴⁴⁸ s 601NC.

⁴⁴⁹ s 601NC(2). The provisions governing the calling of a meeting of members are contained in Part 2G.4 Divs 1 and 2.

⁴⁵⁰ s 601NC(2)(b), (3).

⁴⁵¹ Definition of ‘extraordinary resolution’ in s 9.

⁴⁵² s 601ND.

same meeting, pass a resolution choosing as the new RE a company that consents to be RE.⁴⁵³

Submissions

Scheme constitution

One respondent⁴⁵⁴ was concerned that a scheme constitution could permit an RE unilaterally to wind up a scheme without consulting scheme members, as is otherwise necessary where an RE seeks to wind up a scheme.

Scheme members

Some respondents⁴⁵⁵ supported the current extraordinary resolution threshold for scheme members to initiate a scheme winding up. They considered that an ordinary or special resolution threshold may enable a small but active minority of members to force a premature winding up of the scheme for their own benefit. Other respondents⁴⁵⁶ proposed a revised threshold, namely 75% of the votes cast by scheme members at a meeting, provided that the votes cast in favour constitute at least 25% of the total votes of scheme members.

The RE

One respondent⁴⁵⁷ submitted that the current 28 day period for members to call for a meeting following notification by an RE of its intention to wind up a scheme⁴⁵⁸ has not proved to be sufficient (particularly for schemes with a large number of members) and suggested that either:

- the 28 day period be extended, or
- members be allowed to inform the RE directly within a certain timeframe whether they would like a meeting.

⁴⁵³ s 601NE(1)(d).

⁴⁵⁴ ASIC.

⁴⁵⁵ McCullough Robertson, Property Funds Association.

⁴⁵⁶ IPA, Clarendon Lawyers.

⁴⁵⁷ ASIC.

⁴⁵⁸ s 601NC(2).

Another respondent⁴⁵⁹ proposed that an RE be permitted to wind up the scheme if the scheme members call a meeting, but fail to pass an extraordinary resolution directing the RE not to wind up the scheme.

CAMAC position

CAMAC notes the concern about the possibility of a scheme constitution allowing an RE to bypass the consultation process with scheme members, and the concern about the adequacy of the current 28 day period for members to call a meeting where the RE seeks to wind up a scheme. While not convinced at this stage that there are sufficient instances of problems arising in practice to justify immediate reform, CAMAC suggests that amendment to the law be considered if problems in this area develop.

In regard to the process where a meeting of scheme members is called following notification by an RE of its intention to wind up a scheme, CAMAC considers that to place an onus on scheme members to pass an extraordinary resolution to block an intention of an RE to wind up a scheme could make it too easy for an RE to wind up a scheme.

The passing of any resolution by scheme members to terminate a scheme, under either s 601NB or s 601NC, should require the involvement of a significant proportion of the members. However, the current extraordinary resolution requirement under both these provisions, that the resolution be approved by at least 50% of the total votes that may be cast by members entitled to vote on the resolution (whether or not cast) may in practice make it impossible for members to approve the winding up of a scheme, particularly a pooled scheme involving large numbers of passive investors.

CAMAC considers that the threshold for scheme members to approve the winding up of their scheme under either s 601NB or s 601NC should be amended to:

- 75% of the votes cast on the resolution, provided that

⁴⁵⁹ Alan Jessup proposed that an RE be permitted to wind up the scheme 'if the members do call a meeting but at that meeting no extraordinary resolution that the members propose about the winding up of the scheme is passed other than that the scheme be wound up'.

- the votes cast in favour of the winding up constitute at least 25% of the total votes of scheme members.⁴⁶⁰

While less stringent than the current threshold, the proposed threshold for members to wind up a scheme is still higher than the threshold proposed by CAMAC for scheme members to change the RE of an unlisted scheme.⁴⁶¹ The rationale for the proposed higher threshold is that winding up a scheme is a much more serious step than changing the RE of an unlisted scheme.

An RE that fails to get a scheme wound up under s 601NC could seek, where appropriate, to have the scheme wound up under the current ‘just and equitable’ ground (see below) or under the additional ‘insolvency’ ground proposed by CAMAC.⁴⁶² Alternatively, that RE could notify its intention to retire from that position.⁴⁶³

7.2.3 Initiating a winding up by court order

Current position

Just and equitable ground

A court may, on application by the RE, a director of the RE, a scheme member or ASIC, direct the RE to wind up a scheme where it ‘thinks it is just and equitable to make the order’.⁴⁶⁴ This is a broad general ground which, applying the approach for companies, enables the court to consider any aspect of the internal or external functioning of a scheme in determining whether it should be

⁴⁶⁰ This amendment would require some consequential amendments, for instance, to s 601NE(1)(b), which refers to scheme members passing an extraordinary resolution directing the RE to wind up the scheme, and to Part 2G.4.

⁴⁶¹ In Section 5.4.3 of this report, CAMAC proposes that a resolution to change the RE of an unlisted scheme require a simple majority of the votes cast on the resolution, provided that the total of the votes cast on the resolution (for and against) constitute at least 25% of the total votes of scheme members.

⁴⁶² See Section 7.4.1 of this report.

⁴⁶³ s 601FL. Where an RE wishes to retire from that position, but a new RE is not available, a court can appoint a TRE to operate the scheme on an interim basis while a new RE is sought: s 601FP and Corp Reg 5C.2.02. See further chapter 5.

⁴⁶⁴ s 601ND.

terminated.⁴⁶⁵ In this context, the court could consider, but would not be confined to, the financial state of the scheme, its assets and future prospects.⁴⁶⁶

Failure to choose new RE after appointment of TRE

The court may direct a TRE to wind up the scheme if a meeting to choose a new RE is not called within three months of the appointment of the TRE⁴⁶⁷ or the meeting was called but did not result in the members choosing a new RE that consented to act in that role.⁴⁶⁸ Where a new RE has not been appointed under this process, the TRE must make a winding up application to the court. If the TRE does not apply, application may be made by ASIC or a scheme member.⁴⁶⁹

Submissions

It was suggested that, in addition to its existing powers, a court should be permitted to wind up a scheme where it is satisfied that the scheme's purpose cannot be accomplished.⁴⁷⁰

CAMAC position

The courts have given a broad ambit to the just and equitable ground for winding up a scheme, which can include the internal processes of the scheme as well as its overall financial position, its assets and its future prospects. CAMAC elsewhere recommends that the court be given an additional express power to wind up a scheme where it is satisfied that the scheme is insolvent.⁴⁷¹ Given this, a further ground that the court considers that scheme's purpose cannot be accomplished may be unnecessary and could require the court to

⁴⁶⁵ A winding up on the just and equitable ground might be permitted where 'the administration and original arrangement had broken down': *Capelli v Shepard* [2010] VSCA 2 at [86], citing *Australian Securities and Investments Commission v Knightsbridge Managed Funds Ltd* [2001] WASC 339 at [63]. See also *Re PWL; ex parte PWL Ltd (formerly Palandri Wines Ltd) (administrators appointed)* [No 2] [2008] WASC 232 at [43], cited in *Capelli v Shepard* [2010] VSCA 2 at [87].

The case law on the winding up of corporations on the just and equitable ground informs the application of this section: *Capelli v Shepard* [2010] VSCA 2 at [104].

⁴⁶⁶ See the discussion of the application of the just and equitable grounds at Section 7.4.1 of this report.

⁴⁶⁷ s 601FQ(5)(a).

⁴⁶⁸ s 601FQ(5)(b).

⁴⁶⁹ s 601FQ(5).

⁴⁷⁰ ASIC.

⁴⁷¹ See Section 7.4.1 of this report.

reach commercial decisions which are beyond its judicial role. This is a matter for consideration by scheme members under the procedure in s 601NC.

7.2.4 Person to conduct the winding up

Current position

The RE

The responsibility for winding up a scheme rests in the first instance with the RE.⁴⁷² As observed in *Re Environinvest Ltd*:⁴⁷³

Winding up the scheme is plainly part of the business of the responsible entity.

By contrast, all company windings up, including for solvent companies, are under the control of an external liquidator. However, the corporate structure has no equivalent of an RE.

Other parties

The court, upon application by the RE, a director of the RE, a member of the scheme, or ASIC, may make an order appointing a person other than the RE to take responsibility for ensuring that a scheme is wound up in accordance with its constitution and any directions that the court makes.⁴⁷⁴ There is no statutory restriction on whom the court can appoint for that purpose. The court may act if it ‘thinks it necessary to do so (including for the reason that the responsible entity has ceased to exist or is not properly discharging its obligations in relation to the winding up)’.

⁴⁷² s 601NE.

⁴⁷³ [2009] VSC 33 at [65].

⁴⁷⁴ s 601NF.

Submissions

The general view of respondents was that the RE should conduct the winding up of a solvent scheme, subject to the court appointing another party for this purpose.⁴⁷⁵

CAMAC position

The current position should continue, whereby the winding up of a solvent scheme is conducted by the RE, with provision for the court to appoint another person for that purpose if the court thinks it necessary to do so.

7.2.5 The winding up process

Current position

The Corporations Act does not provide guidance on the process of winding up a solvent scheme, once that decision has been made. The only legislative requirement is that the winding up be conducted in accordance with the constitution of the scheme and any orders of the court.⁴⁷⁶

A scheme constitution may set out the prerequisites for the scheme to be wound up and the winding up procedure to be adopted. Typically, a scheme constitution provides for members to receive a pro rata share of scheme property after all creditors have been paid.

In addition to the terms of a scheme constitution, the person conducting the winding up can look for guidance to general law and trust principles:

Where the scheme is a trust, what is envisaged by the winding-up of a scheme is the realisation of its property, the payment by the responsible entity of liabilities incurred on behalf of the scheme or the retention by it of funds with which to meet its liabilities, the ascertainment of the members' entitlements, and the distribution of the trust

⁴⁷⁵ Financial Services Council, Property Funds Association, Baker & McKenzie, AAR, Clarendon Lawyers, McCullough Robertson. The IPA considered it arguable that all scheme windings up should be undertaken by a suitably qualified third party, being a registered liquidator, but recognised that it may be reasonable for an RE that is not itself insolvent to attend to the winding up where all creditors will be paid in full.

⁴⁷⁶ ss 601NE, 601NF.

assets to the members in accordance with their entitlements. The winding-up of a trust involves the performance of the trust, by the trustee's accounting to the beneficiaries for trust property in accordance with the terms of the trust, and its termination.⁴⁷⁷

Submissions

Respondents that commented⁴⁷⁸ generally considered that legislative prescription concerning the winding up process for a solvent scheme was unnecessary. Reasons given included:

- the trustee duties at general law and statutory RE duties provide the flexibility necessary to deal with the multiple types of scheme trust arrangements
- the method for winding up a scheme will depend on its particular structure.

One of those respondents⁴⁷⁹ saw merit in expanding (or otherwise clarifying) the requirement⁴⁸⁰ that a scheme constitution must make adequate provision for 'winding up the scheme', for instance, by adding the words 'including the process by which the scheme will be wound up'.

CAMAC position

It is unnecessary to prescribe detailed legislative provisions for the winding up process of a solvent scheme, given the variety of scheme structures, and the lack of external creditors. Also, the existing requirement that a scheme constitution 'make adequate provision' for the winding up of a scheme would imply that the scheme constitution include a process by which the scheme will be wound up.

If a scheme constitution does not provide adequate detail to deal with the circumstances of the winding up, or applicable general law principles do not satisfactorily resolve an issue, the party conducting the winding up should be able to seek directions from the court (see Section 7.2.6, below).

⁴⁷⁷ *Stacks Managed Investments Ltd* [2005] NSWSC 753 at [42].

⁴⁷⁸ Financial Services Council, Baker & McKenzie, AAR.

⁴⁷⁹ AAR.

⁴⁸⁰ s 601GA(1)(d).

7.2.6 Court supervision power

Current position

The court, upon application by the RE, a director of the RE, a scheme member or ASIC, may give directions about how a scheme is to be wound up ‘if the Court thinks it necessary to do so’.⁴⁸¹ If the court appoints another person to take responsibility for the winding up of a scheme, the legislation does not give that person standing to seek directions.⁴⁸² However, the court may provide judicial advice or direction under its inherent powers, for instance in relation to schemes in the form of trusts.⁴⁸³

The statutory power of the court to give directions has been interpreted as being subject to certain limitations, namely that the court:

- cannot give directions of its own motion⁴⁸⁴
- probably can only give directions concerning an actual conflict, not potential conflicts⁴⁸⁵
- cannot use the directions power to affect the rights of, or impose duties on, external parties.⁴⁸⁶

This position, which applies to the winding up of registered schemes, can be contrasted with the position for unregistered schemes, where the court has a more widely drawn discretion, namely, to ‘make any orders it considers appropriate for the winding up of the scheme’.⁴⁸⁷

⁴⁸¹ s 601NF(2), (3).

⁴⁸² By comparison, in a corporate winding up, the liquidator may apply to the court for directions in relation to any particular matter arising under the winding up: s 479(3).

⁴⁸³ See, for instance, *Re Westfield Holdings Ltd* (2004) 49 ACSR 734 at [3], *Re Abacus Funds Management Ltd* [2005] NSWSC 1309, *Macquarie Private Capital A Ltd* [2008] NSWSC 323 at [3], *Re Macquarie Capital Alliance Ltd* [2008] NSWSC 745 at [19], *Re Macquarie Communications Infrastructure Group* [2009] NSWSC 487 at [16], *Re Elders Forestry Management Ltd* [2012] VSC 287 at [6]-[7].

⁴⁸⁴ *Re Orchard Aginvest Ltd* [2008] QSC 2.

⁴⁸⁵ *ibid.*

⁴⁸⁶ *Stacks Managed Investments Ltd* [2005] NSWSC 753 at [52] and [55], *Capelli v Shepard* [2010] VSCA 2 at [146].

⁴⁸⁷ s 601EE(2).

Submissions

Various respondents⁴⁸⁸ considered that the court should have a general discretionary power to make orders or give directions, to enable the court to deal with the breadth and variety of structures, arrangements and relationships that may be involved with some complex schemes.

Some submissions argued that, in addition to the person conducting the winding up, a range of other persons could be given standing to apply to the court for the exercise of its discretionary powers (including ASIC or scheme members) or a more generic test of standing could be adopted, such as ‘any interested person’.⁴⁸⁹

Some respondents⁴⁹⁰ did not favour a wide court power to give directions.

CAMAC position

To ensure that the court has sufficient power to give directions concerning the winding up of a scheme (whether solvent or insolvent), s 601NF(2) should be amended to enable the court to give directions whenever it thinks it appropriate to do so, including in relation to any particular matter arising under the winding up of a solvent or insolvent scheme.

Standing to seek court directions under s 601NF(3) should be extended to any person conducting the winding up of a scheme, whether solvent or insolvent.

See also Section 7.5.4 of this report.

7.2.7 Transition from solvent to insolvent winding up

Current position

Given that there is no specific legislative distinction between solvent and insolvent scheme windings up, there is no provision for a transition from a solvent to an insolvent winding up of a scheme.

⁴⁸⁸ ASIC, McCullough Robertson, Baker & McKenzie, Property Funds Association, Clarendon Lawyers.

⁴⁸⁹ McCullough Robertson, Clarendon Lawyers, Baker & McKenzie.

⁴⁹⁰ IPA, AAR.

A corporate voluntary winding up is carried out as a members' voluntary winding up (a solvent winding up) if the directors make a written declaration of solvency.⁴⁹¹ This type of corporate winding up involves only the company's members.⁴⁹²

However, if the liquidator appointed to carry out the members' voluntary winding up forms the opinion at any time that the company will not be able to pay its debts in full, the liquidator must:

- apply to the court for a winding up in insolvency,⁴⁹³ or
- appoint an administrator,⁴⁹⁴ or
- convene a meeting of the company's creditors, by a notice conveying the names, addresses and estimated amounts of claims of the creditors and notifying them of their right to appoint a new liquidator at the meeting.⁴⁹⁵ The liquidator must lay before the meeting a statement of the assets and liabilities of the company.⁴⁹⁶

CAMAC position

There should be provision for the solvent winding up of a scheme to become an insolvent winding up of the scheme, along the lines of the provisions applicable to companies. The person conducting the winding up of a scheme, who would be best placed to determine whether all creditors can or cannot be paid, should have powers and obligations comparable to those of a corporate liquidator, as set out above.

To avoid potential conflicts of interest where a scheme transfers from a solvent to an insolvent winding up, only a registered liquidator should be permitted to conduct the insolvent winding up of a scheme.⁴⁹⁷

⁴⁹¹ s 494.

⁴⁹² Part 5.5 Div 2.

⁴⁹³ ss 496(1)(a), 459P.

⁴⁹⁴ ss 496(1)(b), 436B.

⁴⁹⁵ s 496(1)(c), (2)-(7).

⁴⁹⁶ s 496(4).

⁴⁹⁷ The nature of these potential conflicts of interest is discussed in Section 7.3.2 of this report.

7.3 Winding up an insolvent scheme that has been in VA

This Section deals with winding up procedures if a VA regime for schemes is introduced (see chapter 6 of this report).

As earlier indicated, this report defines a scheme as insolvent if the scheme property is insufficient to meet all the claims that can be made against that property as and when they become due and payable.⁴⁹⁸

7.3.1 Combined or separate winding up

If a VA regime is introduced under the current legal framework

If a scheme has gone into VA, that VA procedure will determine whether it will immediately or eventually be wound up, and whether it is wound up as part of the winding up of its RE (if insolvent) or through a separate winding up process.⁴⁹⁹

If a VA regime is introduced under the SLE Proposal

Likewise, under the SLE Proposal, if a scheme has gone into VA, that VA procedure will determine whether it will immediately or eventually be wound up. However, given the separation of the affairs of the scheme from those of the RE in this case, a separate winding up procedure for an insolvent scheme would generally be required.⁵⁰⁰

7.3.2 Who should conduct any separate scheme winding up

Solvent RE and other persons

In some circumstances, under the current legal framework, a scheme may be insolvent while its RE remains solvent. For instance, a multi-function RE may be solvent from its other dealings, while the only creditors of the scheme are parties with limited recourse rights (which are limited to the available property of that scheme).

⁴⁹⁸ See Section 6.3.2 of this report.

⁴⁹⁹ See Section 6.3 of this report.

⁵⁰⁰ See Section 6.4 of this report.

Likewise, under the SLE Proposal, an RE (being only an agent when operating a scheme) may remain solvent though a scheme that it operates has become insolvent. Only in some cases might the insolvency of the scheme lead to the insolvency of its RE.⁵⁰¹

The current legislation does not prohibit a solvent RE from winding up an insolvent scheme that it has operated. The court, however, upon application by various parties, has the power to appoint a person other than a solvent RE to ‘take responsibility’ for the winding up of a scheme.⁵⁰² There is no statutory restriction on whom the court may appoint for that purpose.

Submissions

Some respondents supported a solvent RE being left with the responsibility to wind up an insolvent scheme.⁵⁰³ Several other respondents considered that only a registered liquidator should wind up an insolvent scheme.⁵⁰⁴

CAMAC position

To permit a solvent RE to wind up an insolvent scheme that it has operated could create potential conflicts of interest for that RE, both under the current legal framework and under the SLE Proposal. For instance, the RE may have preferred some creditors over others in disposing of scheme property prior to the scheme going into winding up, or may have continued to trade on behalf of the scheme after it became insolvent (relevant under the SLE Proposal⁵⁰⁵). The RE may be reluctant to take any action over these matters if it were conducting the winding up.

To avoid any conflicts of this nature, and to ensure that an independent assessment can be made of the conduct of the RE as operator of the scheme, the winding up of an insolvent scheme, whether under the current legal framework or the SLE Proposal, should be conducted only by a registered liquidator.

⁵⁰¹ For instance, a sole-function RE may become insolvent following the insolvency of the scheme that it operates where it depends on the profitability of the scheme for its own financial survival.

⁵⁰² s 601NF.

⁵⁰³ Financial Services Council, Baker & McKenzie, AAR.

⁵⁰⁴ IPA, McCullough Robertson, Clarendon Lawyers.

⁵⁰⁵ See Section 3.6 of this report.

A standard requirement of this nature would be preferable to leaving the court to decide, on a case by case basis, whether to replace the RE as liquidator of an insolvent scheme.

7.3.3 Other matters

Some other key issues in developing a separate winding up procedure for insolvent schemes are examined in Section 7.5.

7.4 Winding up an insolvent scheme that has not been in VA

If a VA procedure for schemes is not introduced or, if introduced, is not used in a particular case, consideration needs to be given to:

- who can initiate the winding up of an insolvent scheme
- whether a combined or separate winding up should be adopted if the RE also is insolvent
- who should conduct any separate scheme winding up.

As earlier indicated, a scheme is defined as insolvent if the scheme property is insufficient to meet all the claims that can be made against that property as and when those claims become due and payable.⁵⁰⁶

7.4.1 Initiating the winding up of an insolvent scheme

Current position

Scheme members or the RE

The current legislative provisions for the initiation of a scheme winding up, by scheme members⁵⁰⁷ or by the RE,⁵⁰⁸ apply whether the scheme is solvent or insolvent. An RE may seek to initiate the winding up of a financially stressed scheme where it considers that the purpose of that scheme cannot be accomplished because the

⁵⁰⁶ See Section 6.3.2 of this report.

⁵⁰⁷ s 601NB.

⁵⁰⁸ s 601NC.

scheme is no longer financially viable.⁵⁰⁹ The RE can proceed to wind up the scheme unless a meeting of scheme members is called, in which case the scheme can only be wound up if the members pass an extraordinary resolution to that effect.⁵¹⁰

The court

In contrast to the winding up of a company,⁵¹¹ there is no express legislative power of the court to direct the winding up of a scheme on the basis that it is insolvent. However, the courts have considered the concept of a scheme being insolvent in the context of the general ‘just and equitable’ winding up ground.

Just and equitable ground. The RE, a director of the RE, a scheme member or ASIC can apply to the court to have a scheme wound up on the basis that the court ‘thinks it is just and equitable’ to make the winding up order.⁵¹² The courts have considered the question of the insolvency of a scheme when applying this ground. The general approach, when applied in the context of insolvency, has been to consider the overall financial position of the scheme, its assets and its future prospects. For instance, in *Ex parte PWL Ltd*,⁵¹³ in assessing whether any of several schemes was insolvent or unviable for the purposes of the just and equitable winding up ground, the Court adopted a broad ‘first principles’ approach and considered evidence going to various factors, including operating expenses, operating losses, future income, capital expenditure that would be required to make the scheme commercially viable, the prospects of the scheme being able to trade profitably in the future, and the ability of the RE to fund necessary capital requirements from existing or new members or creditors.⁵¹⁴

Unsatisfied execution. The court may order the RE to wind up a scheme on application by a creditor with an unsatisfied execution on

⁵⁰⁹ RI Barrett, ‘Insolvency of registered managed investment schemes’, Paper delivered at the Conference of the Banking and Financial Services Law Association, Queenstown, July 2008, p 11.

⁵¹⁰ s 601NC(2), (3).

⁵¹¹ s 459A.

⁵¹² s 601ND(1)(a).

⁵¹³ *Re PWL ACN 084 252 488 Ltd; Ex parte PWL Ltd (formerly Palandri Wines Ltd) (admin apptd) (No 2)* [2008] WASC 232.

⁵¹⁴ This summary of the decision is provided by N D’Angelo, ‘When is a trustee or responsible entity insolvent? Can a trust or managed investment scheme be “insolvent”?’ (2011) 39 *Australian Business Law Review* 95 at 102.

a court order.⁵¹⁵ As observed in *Capelli v Shepard*,⁵¹⁶ this ground for winding up:

obliquely suggests insolvency, as an execution returned unsatisfied in favour of a creditor echoes a traditional act of bankruptcy or its corporate equivalent.

Submissions

Some submissions⁵¹⁷ favoured a specific insolvency ground for the court to wind up a scheme, arguing, for instance, that use of the just and equitable ground to wind up a scheme has not been applied consistently where a scheme is not financially viable.

Other respondents⁵¹⁸ questioned the need for a specific insolvency ground on the basis that the courts have been willing to apply the general ‘just and equitable’ ground to wind up an ‘insolvent’ scheme.

One respondent⁵¹⁹ suggested that the administrator or liquidator of an RE should have standing to apply to the court for the winding up of a scheme.

⁵¹⁵ s 601ND(1)(b), (3).

Under the ALRC/CASAC recommendation, this was a presumption of insolvency rather than a separate ground for winding up: vol 2, draft s 581AD(5) (p 219).

RI Barrett, ‘Insolvency of registered managed investment schemes’, Paper delivered at the Conference of the Banking and Financial Services Law Association, Queenstown, July 2008, pp 3-4 expressed doubts about how this ground can be sensibly applied, observing that:

- trust property itself cannot be taken in execution by the creditors of a trustee (*Octavo Investments Pty Ltd v Knight* [1979] HCA 61; (1979) 144 CLR 360 at 367)
- the trustee’s equitable interest in the whole of the trust assets is inseparable from the trustee’s obligations and therefore cannot be taken in execution (even in jurisdictions where statute empowers the sheriff to take equitable interests in specific property under the common law process of execution of a writ of attachment)
- an unsuccessful attempt at execution at law says nothing about the sufficiency of the trustee’s rights against the trust property to meet the creditor’s claim established by judgment or the financial health of the scheme (though the trustee’s lack of non-trust assets may indicate that the RE itself is financially stressed and perhaps should be replaced).

⁵¹⁶ [2010] VSCA 2 at [80].

⁵¹⁷ McCullough Robertson, AAR, Clarendon Lawyers.

⁵¹⁸ Baker & McKenzie, Alan Jessup.

⁵¹⁹ ASIC.

Some submissions⁵²⁰ suggested that unsatisfied execution should be removed as a ground for winding up.

CAMAC position

In addition to the general power to wind up a scheme on the just and equitable ground, the court should be given a specific power to wind up a scheme where satisfied that the scheme is insolvent. This would avoid the court having to use the general just and equitable ground as a de facto insolvency ground. A separate insolvency ground would be particularly important under the SLE Proposal where the RE and its directors may be personally liable for any insolvent trading by a scheme operated by the RE.⁵²¹

Persons entitled to apply to the court for the winding up of a scheme on the basis of its insolvency should be:

- the RE or a director of the RE
- a scheme member
- a scheme creditor (including a contingent or prospective creditor)
- an administrator or liquidator of the RE (more relevant under the current legal framework than under the SLE Proposal)
- ASIC.

Introduction of a specific insolvency ground would make redundant the current unsatisfied execution ground, which could then be repealed.

7.4.2 Combined or separate winding up

In some cases the insolvency of a scheme (or schemes) may lead to, or coincide with, the insolvency of the RE of the scheme (or schemes). Where this occurs, consideration needs to be given to whether it would be preferable to include the winding up of one or

⁵²⁰ ASIC, AAR. The latter respondent is unaware of this ground having been used by a creditor of the scheme, given that it would require obtaining judgment against the RE and the RE then failing to satisfy that judgment.

⁵²¹ See Section 3.6 of this report.

more schemes in the winding up of its RE (a combined winding up) or whether separate winding up procedures for a scheme and the RE should be adopted.

Submissions

Submissions took varying views on whether the liquidations of an RE and one or more of the schemes that it operates should be separate⁵²² or combined.⁵²³

CAMAC position

In some circumstances, a combined winding up may be the most expeditious and cost effective means to finalise the affairs of one or more schemes and the RE. Some legal clarification may be necessary to ensure that the combined winding up option is available.⁵²⁴

In other instances, a combined winding up may create conflicts between competing interests in the winding up. An example may be where a claim by the RE based on the exercise of its indemnity rights against scheme property is subject to dispute. For a liquidator in those circumstances to admit or reject the claim may affect various creditors in different ways. Arguably, this possible conflict could be avoided through separate liquidations, with, for instance, the indemnity rights claim of the RE against scheme property being determined in the winding up of the scheme.

⁵²² IPA (this respondent also commented that a combined liquidation, with the appointment of a special purpose liquidator to attend to the matters of conflict, may be a more cost effective solution), Property Funds Association, Clarendon Lawyers. McCullough Robertson also supported separate liquidations as the default position, but with a right for members and creditors of the RE and the scheme to agree on joint liquidations.

⁵²³ IPA suggested (as an alternative to requiring separate liquidations) combining the liquidations, but having a special purpose liquidator to attend to any areas of conflict.

⁵²⁴ In *Silvia, in the matter of FEA Plantations Ltd (Administrators Appointed)* [2010] FCA 468, the Court considered that the affairs of a scheme being managed by the RE could, in principle, be dealt with under a VA of the RE, given the wide definition of 'affairs of a body corporate' in s 53. By contrast in *Owen, in the matter of RiverCity Motorway Pty Limited (Administrators Appointed) (Receivers and Managers Appointed) v Madden (No 3)* [2012] FCA 313 at [7], the Court expressed doubts about whether the VA of an RE would properly extend to any scheme that it operates.

Where the winding up of an insolvent scheme is commenced by court order, the question of whether there should be a combined or separate winding up where the RE is also being wound up could be a matter for the court to determine in light of the particular circumstances of the case.

Where the winding up of an insolvent scheme is commenced by any party other than the court, and the RE is also being wound up, the liquidator of the RE should administer a combined scheme and RE winding up, unless or until the liquidator determines that in the circumstances it would be preferable to have separate windings up for one or more of the schemes. ASIC or any affected party should have standing to apply to the court to review the approach being taken by the liquidator of the RE.

7.4.3 Who should conduct any separate scheme winding up

CAMAC position

For the same reasons as set out in Section 7.3.2, the winding up of an insolvent scheme should be conducted only by a registered liquidator.

7.4.4 Other matters

Some other key issues in developing a separate winding up procedure for insolvent schemes are examined in Section 7.5.

7.5 Procedural issues where an insolvent scheme is to be wound up separately from its RE

7.5.1 Context

Where a scheme and its RE are in a combined insolvent winding up, the liquidator of the RE is subject to detailed provisions in Chapter 5 of the Corporations Act regarding the winding up of the RE (being a public company), whose affairs should include the affairs of the scheme.⁵²⁵

⁵²⁵ See CAMAC position in Section 7.4.2.

However, there is no legislative guidance on the procedures to be followed in the separate winding up of an insolvent scheme. It is unlikely that the provisions of a scheme constitution would provide adequate, or necessarily appropriate, guidance, particularly in regard to dealing with outstanding creditor claims. The only assistance may come from the power of the court to give directions about how a scheme is to be wound up.⁵²⁶

This Section discusses some implementation issues that would arise in developing legislative direction or guidance concerning the separate winding up an insolvent scheme.

7.5.2 Ambit of the winding up

For the reasons set out below, CAMAC considers that the ambit of a scheme winding up should be narrower than the ambit of a scheme VA.

As proposed earlier in this report, each scheme should have a register of agreements and a register of scheme property, which various parties, including a liquidator of a scheme, could treat as definitive.⁵²⁷

CAMAC envisages that the winding up of a scheme, like the proposed scheme VA procedure, would cover all property on the register of scheme property. However, unlike under a scheme VA, where the moratorium would cover all agreements on the agreements register,⁵²⁸ a scheme winding up should only cover agreements in so far as they involve scheme property. Under the current legal framework, this would cover agreements containing limited recourse rights, and all claims under the subrogation remedy. Under the SLE Proposal, this would cover all agreements by counterparties with the RE as agent for the MIS (including agreements coming within the indoor management rule).

A scheme winding up should not cover claims that counterparties may have against the personal assets of the RE, or scheme members, under agreements entered into with them as principals. The rights of these counterparties should be determined according to the terms of

⁵²⁶ s 601NF(2), (3).

⁵²⁷ Sections 4.3.4 and 4.4.3.

⁵²⁸ See Section 6.5.1 of this report.

each agreement (which, for instance, may include a clause that the agreement will terminate automatically if the scheme is wound up).⁵²⁹

7.5.3 General procedures for conducting the winding up

ALRC/CASAC report

The ALRC/CASAC report envisaged a series of procedural powers and obligations for the liquidator in the winding up of a scheme. These included:

- provisions relating to the protection of scheme property⁵³⁰
- a power for the liquidator of a scheme to apply to the court for the compulsory examination of persons in relation to the scheme, in the same way as the liquidator of a company⁵³¹
- duties of the liquidator, including to report to ASIC on any wrongdoing by relevant persons⁵³² and to keep proper books,⁵³³

⁵²⁹ An agreement might provide that certain rights or obligations given in the agreement are to be extinguished or adjusted if the scheme goes into external administration. For instance, in *Re Elders Forestry Management Ltd* [2012] VSC 287 at [13], the Court noted that the vast majority of sub-lease agreements by scheme members in an agribusiness common enterprise scheme stated that the agreements would terminate automatically if the scheme is wound up.

⁵³⁰ Court powers relating to prohibiting officers from removing relevant property from the jurisdiction, appointing a receiver and surrendering passports are dealt with in vol 2, draft s 486AA (pp 214-215) (cf s 486A(1), (2) for companies).

A court power to issue an arrest warrant is dealt with in draft replacement s 486B(1)(a), (3)(a), (b), (c) (p 216), which apply to schemes as well as companies and replace the current provisions that apply to companies only.

⁵³¹ vol 2, draft amendments to ss 596A, 596B of the corporations legislation (p 229). The liquidator would have to give notice of an examination to as many of the creditors of the scheme as reasonably practicable: vol 2, draft amendment to s 596E of the corporations legislation (p 229).

⁵³² vol 2, draft s 581DI (pp 227-228). For companies, cf s 533. The liquidator would have qualified privilege in performing this function: vol 2, draft s 581DK (p 228) (cf s 535 for companies).

⁵³³ vol 2, draft s 581DJ (p 228). Cf s 531 for companies. A liquidator of a company must keep books containing entries or minutes of proceedings at all meetings and any other matters required to give a complete and correct record of the liquidator's administration of the company's affairs (s 531; Corp Reg 5.6.01). The liquidator must make the books available for inspection at the liquidator's office, in the absence of a court order (s 531; Corp Reg 5.6.02).

Other possible duties are to have regard to directions given by creditors (cf s 479(1) for companies in a court winding up) and to convene meetings of creditors in certain circumstances (cf s 479(2) for companies in a court winding up).

as well as certain requirements relating to money received by a liquidator⁵³⁴

- a requirement for officers of the RE to give assistance to the liquidator⁵³⁵
- court powers to make various orders, including for the delivery of property to the liquidator,⁵³⁶ to make such orders as are just⁵³⁷ and to make appropriate orders concerning persons guilty of misconduct causing loss to a scheme⁵³⁸
- public notification requirements⁵³⁹
- a prohibition on an RE of a scheme that has been terminated issuing or accepting new subscriptions related to a particular scheme without the leave of the court or carrying on business of the scheme except so far as the scheme liquidator permits for the better winding up of the scheme⁵⁴⁰
- provisions voiding an enforcement action against scheme property⁵⁴¹ or a transfer of interests or alteration in the status of scheme investors.⁵⁴²

Issue

What legislative procedures should there be for the winding up of an insolvent scheme?

Submissions

While views differed as to the extent that procedural prescription for winding up an insolvent scheme was necessary or beneficial, there was significant support for the liquidator of an insolvent scheme

⁵³⁴ cf s 538 for companies.

⁵³⁵ vol 2, draft ss 581DG (p 226), 581DH (pp 226-227). For companies, cf ss 475, 494, 530A.

⁵³⁶ For companies, cf s 483.

⁵³⁷ vol 2, draft s 581DL (p 228). Eligible applicants would be ASIC, the liquidator or an interested person.

⁵³⁸ vol 2, draft amendment to s 598 of the corporations legislation (p 229).

⁵³⁹ vol 2, draft s 581BI (p 222). For companies, cf ss 537, 541.

⁵⁴⁰ vol 2, draft s 581DB (p 225). For companies, cf s 471A.

⁵⁴¹ vol 2, draft s 581DD (p 225). For companies, cf s 471B.

⁵⁴² vol 2, draft s 581DE (p 225). For companies, cf s 468A.

having information-gathering and other investigative powers, as well as an obligation to report possible misconduct to ASIC.⁵⁴³

CAMAC position

The Corporations Act should regulate the winding up of an insolvent scheme in a manner comparable to the regulation of the winding up of an insolvent company, including by:

- suspending the powers of the RE to operate the scheme
- giving the liquidator of the scheme powers, rights and obligations comparable to those of the liquidator of an insolvent company, including a power to operate the scheme for the purpose of its winding up.

The ALRC/CASAC report provides useful guidance on the content of legislative procedures for the winding up of an insolvent scheme. Some key implementation issues are also considered below.

7.5.4 Court power to supervise the winding up of an insolvent scheme

Current position

Upon the application of the RE, a director of the RE, a scheme member or ASIC, the court may give directions about how a scheme is to be wound up ‘if the court thinks it necessary to do so’.⁵⁴⁴ If the court appoints a person other than the RE to take responsibility for the winding up of a scheme, the legislation does not give that person standing to seek directions.

The court may also provide judicial advice or directions under its inherent powers.⁵⁴⁵ Courts have provided directions on a number of occasions in the context of the insolvency of a scheme.⁵⁴⁶

⁵⁴³ IPA, Baker & McKenzie, McCullough Robertson, Clarendon Lawyers, Alan Jessup. Baker & McKenzie said that the information-gathering and other investigative powers should be subject to court or ASIC supervision to prevent abuse.

⁵⁴⁴ s 601NF(2), (3).

⁵⁴⁵ See, for instance, *Re Elders Forestry Management Ltd* [2012] VSC 287 at [6]-[7].

Issues

Should there be any changes to the current provisions by which the court can give directions in relation to the winding up of a scheme, and, if so, what and why?

In this context, should there be a general discretionary power along the lines of s 447A for the court to make such orders as it thinks appropriate about how the scheme liquidation provisions are to operate in relation to a particular scheme? If so, who should be entitled to apply?

Submissions

The submissions summarised in Section 7.2.6 also apply to this matter.

CAMAC position

CAMAC elsewhere recommends:

- expansion of the current legislative power for the court to give directions in the winding up of a solvent or insolvent scheme, by replacing the power to act where the court considers that this is ‘necessary’ with a power to act where the court considers that this is ‘appropriate’
- a statutory right for anyone conducting the winding up of a solvent or insolvent scheme to seek those directions.⁵⁴⁷

7.5.5 Rights of priority creditors**Current position**

There is no provision for an order of priority for the distribution of scheme property in the winding up of an insolvent scheme.⁵⁴⁸

⁵⁴⁶ *Re Timbercorp Securities Ltd (No 2)* [2009] VSC 411; *Re Timbercorp Securities Ltd* [2010] VSC 50; *Re Great Southern Managers Australia Ltd (No 1)* [2009] VSC 557; *Re Great Southern Managers Australia Ltd (No 2)* [2009] VSC 627; *Re Willmott Forests Ltd (No 2)* [2012] VSC 125.

⁵⁴⁷ Section 7.2.6.

⁵⁴⁸ In *Stacks Managed Investments Ltd* [2005] NSWSC 753 at [44], the Court said:

By contrast, the Corporations Act stipulates that debts and claims in the winding up of a company rank equally,⁵⁴⁹ subject to certain priority payments.⁵⁵⁰

The issue of priority of payments can create difficulties in practice. For instance, problems have arisen where the court has sought to appoint someone other than the liquidator of an RE as the liquidator of a scheme that it operates. In *Re Environinvest Ltd*,⁵⁵¹ the court ordered that a separate liquidator be appointed to a scheme, even though it considered that the liquidator of the RE could ‘discharge the responsibility of winding up the schemes, provided adequate measures were put in place to ensure that any possibility for conflict could be dealt with by appropriate undertakings and directions’. However, the court also ordered that the liquidator of the RE and its receivers be indemnified for their costs and expenses from the assets of the RE in priority to those of the liquidator of the scheme.⁵⁵² When no-one was prepared to become liquidator of the scheme on those terms, the court appointed the liquidator of the RE as the liquidator of the scheme.⁵⁵³

Issues

Should there be a statutory order of priority in the winding up of a scheme? If so, what should it include (for instance, the remuneration and costs incurred by the liquidator of the scheme)?

There can be no question of settling an order of priority of “scheme creditors”, or of precluding “scheme creditors” from taking or continuing proceedings for the recovery of their debts, or requiring them to submit to a process of lodgement of proof of debts with consequent appeals to the court from a decision on the acceptance or rejection of proofs.

The ALRC/CASAC report envisaged that property of a scheme being wound up would be distributed first in payment of scheme liabilities and then to scheme members (vol 1, para 8.11; vol 2, draft s 581DF (pp 225-226)). The report observed that provisions for proofs of debt, based on those in the corporations legislation, would be required: vol 1, p 78, footnote 32.

⁵⁴⁹ s 555.

⁵⁵⁰ s 556.

⁵⁵¹ [2009] VSC 33 at [134].

⁵⁵² id at [146].

⁵⁵³ J Ball & J Moutsopoulos, ‘The Ultimate Intangible: ‘Insolvent’ Unit Trusts in Australia’ *Insol World* (First Quarter 2011) 10 at 11.

Submissions

Several submissions⁵⁵⁴ favoured a statutory order of priority, which would include the remuneration and costs incurred by the liquidator of the scheme in relation to that scheme. Most of those respondents⁵⁵⁵ considered that the priority for the liquidator's or administrator's fees and costs in a liquidation of an insolvent scheme or a winding up of a scheme in VA should be as similar as possible to,⁵⁵⁶ or the same as,⁵⁵⁷ that for companies.

One respondent suggested as an alternative to a legislative order of priorities that each scheme constitution be required to contain an order of priority on winding up.⁵⁵⁸

One respondent⁵⁵⁹ said that it would be necessary to resolve the relative priority between amounts due to the previous (now insolvent) RE under its right of indemnity and amounts due to any liquidator, administrator or new RE of the scheme. Possible approaches to this issue include:

- the scheme liquidator recovering costs and expenses from scheme property and the RE liquidator recovering costs and expenses from the assets of the RE⁵⁶⁰
- each liquidator having her or his remuneration and expenses paid pro rata from the scheme property.⁵⁶¹

One respondent raised the impact of the *Sons of Gwalia* decision⁵⁶² on schemes. The main issue would be whether scheme members should have their interests postponed behind other scheme creditors, as is the case for shareholders since the enactment of the *Corporations Amendment (Sons of Gwalia) Act 2010*.

⁵⁵⁴ IPA, McCullough Robertson, Alan Jessup, Baker & McKenzie, Financial Services Council.

⁵⁵⁵ IPA, Baker & McKenzie, McCullough Robertson, Financial Services Council. ASIC and Clarendon lawyers also considered that there should be some statutory priority for the fees of liquidators and administrators appointed to schemes.

⁵⁵⁶ IPA, Baker & McKenzie.

⁵⁵⁷ McCullough Robertson, Financial Services Council.

⁵⁵⁸ AAR.

⁵⁵⁹ IPA.

⁵⁶⁰ IPA, McCullough Robertson.

⁵⁶¹ Baker & McKenzie.

⁵⁶² *Sons of Gwalia Ltd v Margaretic* [2007] HCA 1.

CAMAC position

The legislation should provide for a statutory order of priorities in the winding up of a scheme, based on that provided for companies in s 556 and adjusted, where necessary, for schemes.

Some of the priorities in s 556 would be less applicable to schemes than to companies. For instance, employees would be engaged by the RE and their rights to priority payment would be determined in the winding up of the RE (if insolvent).

The claims of any scheme administrator, scheme deed administrator, or scheme liquidator should share the same priority and rank equally among themselves, as in a corporate liquidation.⁵⁶³

However, claims of the TRE for its fees and any costs in assisting an external administrator should have priority over the claims of any external administrator of the scheme. Without this further priority, any entity contemplating the role of a TRE would have to consider the likelihood of the scheme going into external administration before accepting the appointment. By contrast, an external administrator would be aware that the scheme is in financial stress when taking up the appointment, and that the priority provisions for payment of its costs and remuneration would apply.

A former RE or a new RE with claims against scheme property under its indemnity rights should be treated as an unsecured, non-priority, creditor of the scheme.

The position of scheme members, in relation to their procedural and statutory rights as scheme members, should be comparable to that of shareholders in a company.

7.5.6 Voidable transactions

Current position

The voidable transaction provisions,⁵⁶⁴ which apply to insolvent companies in liquidation, empower the court to set aside transactions

⁵⁶³ Paragraph 556(1)(a) gives equal priority in a corporate liquidation to expenses properly incurred by a 'relevant authority', defined in s 556(2) as any liquidator, provisional liquidator, administrator or deed administrator of the company.

⁵⁶⁴ Pt 5.7B Div 2.

that were entered into by the company before the winding up began and that may give an undue advantage to counterparties or beneficiaries of those transactions over other creditors in obtaining payment out of corporate assets.⁵⁶⁵

Issue

Is there a need for voidable transaction provisions specifically applicable to the winding up of insolvent schemes and, if so, what should be the content of those provisions?

Submissions

Various respondents⁵⁶⁶ supported specific voidable transaction provisions for schemes, based on those applicable to companies.

Some other submissions⁵⁶⁷ were less supportive, raising, for instance, concerns that such provisions could add to the complexity of winding up insolvent schemes.

CAMAC position

There should be voidable transaction provisions applicable in the winding up of an insolvent scheme, based on the exiting provisions applicable to companies. These provisions will help ensure an equitable distribution of available scheme assets.

7.5.7 Position of scheme members

Background

The Parliamentary Joint Committee on Corporations and Financial Services *Inquiry into aspects of agribusiness managed investment schemes* (September 2009) noted the concern expressed by members of some failed agribusiness schemes that in the liquidation of their schemes no person was charged solely with representing their interests.⁵⁶⁸

⁵⁶⁵ V Jewell, 'Corporate law' in I Freckelton & H Selby (eds), *Appealing to the Future: Michael Kirby and his Legacy* (ThomsonReuters, Sydney, 2009) at 160.

⁵⁶⁶ IPA, McCullough Robertson, Financial Services Council, Clarendon Lawyers.

⁵⁶⁷ Alan Jessup, Baker & McKenzie, AAR.

⁵⁶⁸ Paragraphs 3.103 and 3.104.

Issues

What provision, if any, should be made for scheme members in the winding up of their scheme?

Should the liquidator of a scheme have any statutory duty to members of that scheme and, if so, what and why?

Submissions

Provision for members in a winding up

Most submissions that commented⁵⁶⁹ considered that the interests of members of an insolvent scheme should be subordinated to the interests of the creditors of that scheme, in a similar way to the subordination of shareholders' interests to those of a company's creditors.

However, one respondent⁵⁷⁰ proposed that a committee of scheme members should be appointed in a scheme liquidation to oversee the conduct of the liquidator and represent members' interests.

Statutory duty of the liquidator

Submissions that commented⁵⁷¹ did not favour the scheme liquidator having a specific statutory duty to members of the insolvent scheme, arguing, for instance, that:

- the liquidator should not owe members any specific duty beyond his or her general fiduciary duties in that role
- if the scheme is insolvent, the primary duty of the liquidator should be to the creditors of the scheme.

CAMAC position

Members of an insolvent scheme may have property or contractual rights or claims, particularly in common enterprise schemes. It is for the liquidator to assess these matters in determining whether, or in what respect, a scheme member has rights and claims as a creditor of the scheme.

⁵⁶⁹ IPA, Alan Jessup, McCullough Robertson, Baker & McKenzie, Property Funds Association.

⁵⁷⁰ Clarendon Lawyers.

⁵⁷¹ IPA, Alan Jessup, Baker & McKenzie.

Beyond that, appointing a person to represent scheme members in the winding up of a scheme would be out of step with comparable corporate liquidation practice. Where a company goes into liquidation, no-one is appointed specifically to look after shareholder interests.

8 Other matters

This chapter discusses the request in the terms of reference to examine proposals concerning convening scheme meetings, cross-guarantees entered into by REs and statutory limited liability of scheme members.

8.1 PST request

The PST letter asked CAMAC to:

examine other proposals to improve Chapter 5C of the Corporations Act, including in relation to: convening scheme meetings; cross-guarantees entered into by REs on behalf of other group members; and statutory limited liability.

This chapter covers:

- scheme meetings
- cross-guarantees and indemnities provided by an RE
- limited liability of scheme members.

The SLE Proposal does not affect any of these matters.

The chapter does not deal with other proposals to improve Chapter 5C of the Corporations Act that were raised in submissions. Included in the submissions were matters considered in a series of papers in 2001-2002 on schemes by Mr M Turnbull,⁵⁷² Treasury⁵⁷³ and the Parliamentary Joint Committee on Corporations and Financial Services.⁵⁷⁴ These other proposals will be separately considered by CAMAC in a further review.

⁵⁷² *Review of the Managed Investments Act 1998* (December 2001).

⁵⁷³ *Review of the Managed Investments Act 1998: Consultation Paper* (April 2002).

⁵⁷⁴ *Report on the Review of the Managed Investments Act 1998* (December 2002).

8.2 Convening scheme meetings

8.2.1 Current position

An RE has various powers to call a meeting of scheme members.⁵⁷⁵ Likewise, members can require the RE to call, or themselves call, a meeting of members to consider special or extraordinary resolutions.⁵⁷⁶ However, possibly by oversight, members do not have this power in relation to ordinary resolutions, notwithstanding that some matters, in particular the removal of the RE of a listed scheme, are determined by ordinary resolution.⁵⁷⁷ Similarly, the power of the court to call a meeting of members only applies to a proposed special or extraordinary resolution.⁵⁷⁸

ASIC does not have the power to convene meetings of scheme members.

The Turnbull Report recommended that provision be made in the legislation for members to request the RE of a registered scheme to call a general meeting.⁵⁷⁹

There is no provision for an annual general meeting of scheme members.

Issues

Should there be any changes to the provisions concerning the calling of meetings of scheme members and, if so, for what reasons?

For what purposes, if any, should ASIC be granted the power to convene meetings of scheme members?

⁵⁷⁵ ss 252A, 601FL. Also, any related party transactions require the approval of members at a scheme meeting: s 601LC.

⁵⁷⁶ ss 252B-252D.

⁵⁷⁷ Under s 601FM(1), members of a listed scheme who wish to remove the RE may take action under Part 2G.4 Div 1 for the calling of a members' meeting. However, the relevant provisions under this Division, being ss 252B-252D, only refer to calling a members' meeting to consider proposed special or extraordinary resolutions.

⁵⁷⁸ s 252E.

⁵⁷⁹ rec 7.

Should there be provision for an annual general meeting of scheme members and, if so, should the purposes of such meetings be stipulated?

8.2.2 Submissions

Scheme members calling a meeting of scheme members

One respondent noted that, while the only ordinary resolution of scheme members specified in the Corporations Act is to change the RE of a listed scheme, scheme constitutions may provide that certain decisions are to be determined by an ordinary resolution of members. Scheme members have no statutory power to have a meeting of scheme members called to determine any such matter in the scheme constitution.⁵⁸⁰

ASIC calling a meeting of scheme members

One view in submissions was that ASIC should be permitted to call a meeting of scheme members if it has a compelling reason to do so and it reasonably considers that this is in the best interests of scheme members.⁵⁸¹

However, most respondents did not support ASIC being given a specific power to call a meeting of scheme members, considering, for instance, that there is not sufficient evidence of any need that would warrant giving ASIC such a power.⁵⁸²

Annual general meeting of scheme members

Various respondents considered that an annual general meeting of scheme members should be mandatory, noting that this is required for public companies, and that it would provide scheme members with an opportunity to raise with the RE matters concerning the operation of the scheme.⁵⁸³

Other respondents opposed a mandatory annual general meeting of scheme members, pointing to costs and the fact that scheme

⁵⁸⁰ McCullough Robertson.

⁵⁸¹ The Trust Company, Richard Wilkins.

⁵⁸² ASIC, Alan Jessup, McCullough Robertson, Property Funds Association, Financial Services Council.

⁵⁸³ Freehills, Alan Jessup, Richard Wilkins, Primary Securities Ltd.

members already receive product disclosure, continuous disclosure and periodic statements.⁵⁸⁴

8.2.3 CAMAC position

Scheme members can have a meeting of members called to consider a permitted special or extraordinary resolution. However, they have no statutory power to have a meeting of members called to consider an ordinary resolution.

To overcome this limitation on members' rights, ss 252B-252D should be amended to enable members who satisfy the threshold tests in those provisions to direct the RE to call, or themselves to call, a meeting of scheme members for the purpose of considering any ordinary resolution on which scheme members are entitled to vote, including under any provision in the scheme constitution. These statutory provisions already deal with the question of costs where a meeting of scheme members is called at the request, or direction, of scheme members.

Likewise, the court power to order a meeting⁵⁸⁵ should be amended to extend the court's power so that it covers a meeting to consider and vote on an ordinary resolution.

If the powers of scheme members and the court to call scheme meetings are expanded in this way, it is unnecessary also to give ASIC the power to convene a meeting of scheme members, or to mandate an annual meeting of scheme members. If sufficient scheme members are not prepared to call a meeting on a matter on which they are entitled to vote, there does not seem to be a need for ASIC to be given this power or to require that all schemes convene an annual meeting of scheme members.

⁵⁸⁴ ASIC, McCullough Robertson, Property Funds Association, Financial Services Council.

⁵⁸⁵ s 252E.

8.3 Cross-guarantees

8.3.1 Current position

An RE that is in a corporate group may be requested, as part of the group's activities, to provide guarantees or indemnities for various transactions by other entities in that group. These types of financial accommodation may take one of two forms:

- guarantees or indemnities provided by the RE in a capacity other than as operator of a scheme and involving only its personal assets
- guarantees or indemnities provided by the RE in its capacity as the operator of one or more schemes. This could involve permitting an external party to take a security interest over scheme property.

RE acting in non-scheme capacity

There are currently no significant restrictions in regard to an RE entering into guarantees or indemnities concerning the group that involve its personal assets. However, these forms of financial commitment can expose the RE to financial risk from other activities in the group, with the possibility of the RE becoming insolvent or otherwise no longer capable of performing its functions as a scheme operator. This can cause disruption to the operation of any scheme that the RE operates, including the need to attract and appoint a TRE or a new RE to each affected scheme to avoid the liquidation of the scheme.

RE acting as scheme operator

An RE that, in its capacity as operator of a scheme, enters into a guarantee or indemnity that involves scheme property and is unrelated to the activities of that scheme may thereby commit a breach of trust as operator of the scheme, unless the RE is expressly permitted to do so in the constituent documents of the scheme.⁵⁸⁶

⁵⁸⁶ Paragraph 601GA(1)(b) requires that the constitution of a scheme make adequate provision for the powers of the RE in relation to making investments of, or otherwise dealing with, scheme property.

ASIC initiatives

ASIC Consultation Paper 140 *Responsible entities: Financial requirements* (September 2010) proposed that the licensing requirements for REs be amended so that an RE:

- is prohibited from providing guarantees in its capacity as the RE of a scheme
- where the RE manages more than one scheme, is prohibited from providing guarantees in its personal capacity
- is restricted from providing indemnities in its capacity as the RE of a scheme, other than indemnities in relation to the scheme's default.

Following a period of consultation on that Consultation Paper,⁵⁸⁷ ASIC released new financial requirements for REs, to apply from November 2012. They will impose revised minimum standards for REs to have available adequate financial resources to provide the financial services covered by their AFSL.⁵⁸⁸

In lieu of the controls proposed in ASIC Consultation Paper 140 on REs providing guarantees and indemnities, there will be a requirement that each RE estimate the maximum liability under any guarantee it provides (with some exceptions) and exclude this amount from its net tangible asset (NTA) calculation.⁵⁸⁹ The purpose of this approach is to enable the NTA better to reflect the operational risk of the RE, while maintaining flexibility for REs to provide such guarantees, where appropriate.

⁵⁸⁷ ASIC REP 259 *Response to submissions on CP 140 Responsible entities: Financial requirements* highlights the key comments received in the submissions on Consultation Paper 140 *Responsible entities: Financial requirements*.

⁵⁸⁸ Class Order 11/1140 *Financial requirements for responsible entities*. Updated ASIC Regulatory Guide 166 *Licensing: Financial requirements* and Pro Forma 209 (PF 209) are also to apply from November 2012, in line with CO 11/1140.

⁵⁸⁹ See the November 2011 draft of RG 166 *Licensing: Financial requirements* at subparagraph (f) of paragraph 162.

From November 2012, to meet the NTA capital requirements, REs must hold the greater of:

- \$150,000, or
- 0.5% of the average value of scheme property (capped at \$5 million), or
- 10% of the average RE revenue (uncapped).

Issues

In view of the ASIC initiative, should there be any further form of regulation concerning the provision of cross-guarantees or indemnities by REs and, if so, for what reasons?

8.3.2 Submissions

Various respondents were critical of any attempt to prohibit an RE from providing cross-guarantees or indemnities in its personal capacity.⁵⁹⁰ It was argued, for instance, that this form of financial arrangement is a necessary and important business activity for most group-based commercial entities. Prohibiting an RE from giving a guarantee or indemnity involving its personal assets would prohibit many standard financing arrangements within stapled group or other structures that include schemes.

8.3.3 CAMAC position

RE acting in non-scheme capacity

Permitting an RE to enter into cross-guarantees or indemnities involving its personal assets, and not as operator of any particular scheme, may increase the risk of the RE becoming insolvent in its own right and therefore being unable to continue to operate schemes. This may place a scheme itself at risk, as it cannot continue without an RE.

CAMAC has put forward proposals in earlier chapters of this report to assist the process of replacing an RE that cannot fulfil its obligations as RE for whatever reason, including its insolvency. These proposals include removing disincentives under the current law to a suitable entity agreeing to act as the TRE of a scheme until a new RE is found.⁵⁹¹ Also, the SLE Proposal would assist in the task of finding a TRE or a suitable new RE, as an RE, being an agent, not a principal, in operating a scheme, would not in that capacity incur liabilities and obligations that would pass on to a TRE or a new RE.⁵⁹²

⁵⁹⁰ Freehills, Henry Davis York, Alan Jessup, Financial Services Council.

⁵⁹¹ See chapter 5.

⁵⁹² See chapter 3.

CAMAC considers that implementation of these proposals to assist a change of RE of a viable scheme will help to protect a scheme from the consequences of the insolvency of its RE.

Imposing prohibitions or requirements (additional to the foreshadowed ASIC capital requirements) on the ability of the RE to provide guarantees or indemnities in its personal capacity and involving its personal assets may reduce the likelihood of an RE becoming insolvent. However, there was little support in the submissions for restricting the activities that an RE undertakes in its personal capacity so as to reduce the likelihood that the RE will fail, even where (as in the case of some common enterprise schemes) scheme members have prepaid the RE for services or expenses in connection with the scheme and those prepayments form part of the personal assets of the RE (not scheme property held on trust for scheme members) and therefore are lost to scheme members if the RE fails.⁵⁹³ Accordingly, CAMAC does not favour the introduction of this restriction, subject to an ongoing evaluation of ASIC's ability to manage appropriately the risk of RE failure through implementation of its financial requirements policy.

RE acting as scheme operator

CAMAC considers that an outright prohibition on an RE providing guarantees or indemnities involving scheme property may unduly inhibit an RE in operating a scheme for the benefit of scheme members. An RE that provides guarantees or indemnities using scheme property, but without some commercial or financial benefit to the scheme, could be in breach of its statutory and common law obligations as operator of the scheme.

8.4 Limited liability of scheme members

8.4.1 Current position

Inquiries conducted by the Companies and Securities Law Review Committee (1984), the ALRC and CASAC in their collective investments review (1993) and CASAC in its review of the liability of members of managed investment schemes (2000) recommended

⁵⁹³ However, in Section 5.3.2 of this report CAMAC recommends controls on advance payments of remuneration to the RE.

statutory provisions to the effect that (except under arrangements whereby the RE is acting as agent for the scheme members) the members of a scheme should have limited liability for scheme debts that remain outstanding on the winding up of the scheme, in the same manner as shareholders of a company limited by shares.⁵⁹⁴

Further information on these reviews, and the full details of the recommendations by CASAC, are found in the CASAC 2000 report *Liability of Members of Managed Investment Schemes* (March 2000).⁵⁹⁵

The recommendation in the 2000 CASAC report to introduce limited liability for members of registered and ASIC-exempt schemes (but not other unregistered schemes) was based on these persons being passive investors, who, in principle, should have similar protections against personal liability, whether they invest in schemes or in limited liability companies.

However, in some agribusiness common enterprise schemes, the scheme members have sought to be characterised, for taxation and other reasons, as playing a much more active role as ‘growers’ carrying on their own individual businesses, and with proprietary interests in the agricultural land or its produce. This raises the question whether, or in what circumstances, they should not have the protection of limited liability.

Issues

Except where the RE is acting as the agent of the scheme members, should statutory limited liability of scheme members be introduced for all or some schemes?

If so, should distinctions be drawn between different classes of passive or active scheme members, and for what purposes?

Should the limited liability principle be subject to any contrary provision in the scheme constitution?

⁵⁹⁴ See also the discussion at Section 2.6.2 of the Turnbull Report.

⁵⁹⁵ The CASAC 2000 report can be found on the CAMAC website www.camac.gov.au by going to *Publications*, and then to *Reports*.

8.4.2 Submissions

General principle

Respondents considered that, except where the RE is acting as the agent for scheme members, members of a scheme should have statutory limited liability.⁵⁹⁶ Respondents noted that most scheme constitutions seek to do this, but it would be beneficial if limited liability were to be confirmed by statute.

Active and passive scheme members

One view in submissions was that no distinction should be drawn between active and passive scheme members.⁵⁹⁷ One respondent commented, however, that limited liability may sit uneasily with some agribusiness common enterprise schemes where scheme members were described as ‘growers’ with direct rights to cultivate their trees, which concept underpinned the tax effectiveness of their investment.

Scheme constitution

Some respondents supported limited liability of scheme members being subject to any contrary provision in the scheme constitution, with an obligation that the product disclosure statement clearly disclose any such provision to potential investors.⁵⁹⁸

Other respondents opposed a scheme constitution being able to override limited liability of scheme members.⁵⁹⁹ It was pointed out, for instance, that if appropriate disclosure of a contrary provision is not made to scheme members, they may be unaware that they do not have the benefit of limited liability. Also, members who join schemes may, contrary to their wishes, be exposed to personal liability if scheme members by special resolution subsequently approve an amendment to the scheme constitution to override limited liability.⁶⁰⁰

⁵⁹⁶ Alan Jessup, ASIC, McCullough Robertson, Henry Davis York, Freehills, Property Funds Association, The Trust Company, Financial Services Council, Primary Securities Ltd, Ashurst Australia.

⁵⁹⁷ McCullough Robertson, Freehills.

⁵⁹⁸ Alan Jessup, Financial Services Council.

⁵⁹⁹ McCullough Robertson, Henry Davis York.

⁶⁰⁰ s 601GC(1)(a).

8.4.3 CAMAC position

As scheme members, by definition⁶⁰¹ (which applies to common enterprise schemes as well as pooled schemes), do not have day-to-day control over the operation of the scheme, they should not be personally liable for debts incurred by the RE as operator of the scheme. Their liability in the event of the insolvency of the scheme should be limited to any unpaid portion of the amount that they had agreed to contribute to the scheme.⁶⁰²

Current industry practice is to provide for limited liability of scheme members in the scheme constitution. Statutory limited liability would give greater protection to scheme members and provide greater certainty to scheme creditors.

Statutory limited liability would not apply to agreements into which 'active' scheme members (as in some common enterprise schemes) enter on their own behalf or through the RE acting as their agent. Members who are principals to agreements are personally liable according to their terms.

The principle of limited liability should not be subject to any contrary provision in the scheme constitution. The benefits of protection for individual scheme members and certainty for scheme creditors would be undermined if the position could be reversed in the scheme constitution, particularly where that occurs by subsequent amendments to that constitution.

⁶⁰¹ See subparagraph (a)(iii) of the definition of managed investment scheme in s 9.

⁶⁰² cf s 516 for companies.

Appendix Terms of reference

The regulation of managed investment schemes

Since the passage of the *Managed Investments Act 1998*, collective investments, known as managed investment schemes, have been regulated by Chapter 5C of the *Corporations Act 2001* (the Corporations Act). The Corporations Act provides that the main features of a [scheme] are that:

- people are brought together to contribute money to get an interest in the scheme;
- money is pooled together with that of other members or used in a common enterprise; and
- members do not have day to day control over the operation of the scheme.

While the overwhelming majority of funds under management in Australian [schemes] are placed in schemes structured as unit trusts, where investors hold units in the scheme property, the [scheme] structure has also been applied in the agribusiness sector where the members (known as ‘growers’) operate their own individual businesses.

The recent global financial crisis highlighted the difficulties that arise for responsible entities (REs), scheme members, and creditors where a [scheme] comes under financial stress in a credit constrained environment. Those difficulties were evidenced initially through the freezing of investor redemptions in the mortgage fund sector, and then through the collapse of a number of significant participants in the agribusiness [scheme] market.

The collapse of Great Southern Limited and Timbercorp Group led the Parliamentary Joint Committee on Corporations and Financial Services (PJC) to initiate an inquiry into agribusiness managed investment schemes. Submissions to the inquiry highlighted a range of concerns relating to the regulation of agribusiness, including in relation to: the provision of narrow sales recommendations; the ‘one

size fits all' licensing model; the accuracy of disclosure material available to investors, especially in relation to predicted scheme performance; the appointment of temporary REs; and better investor education. The PJC released its report, *Aspects of agribusiness managed investment schemes*, on 7 September 2009.

In that report, the PJC made three recommendations relating to agribusiness [schemes].

- Recommendation 1 related to the tax treatment of agribusinesses.
- Recommendation 2 was that the Government amend the Corporations Act to require ASIC to appoint a temporary RE when a registered [scheme] becomes externally administered or a liquidator is appointed.
- Recommendation 3 related to ASIC requirements for agribusiness [schemes] to disclose the qualifications and accreditation of third parties that provide expert opinion on likely scheme performance.

As part of its *Financial products and services in Australia* report released on 23 November 2009, the PJC also recommended that, as part of their licence conditions, ASIC require agribusiness [scheme] licensees to demonstrate that they have sufficient working capital to meet current obligations (Recommendation 7).

While the recommendations made by the PJC were limited in scope, the PJC Inquiry highlighted the current lack of certainty with respect to the arrangements for dealing with unviable [schemes]. While the corporate insolvency provisions in the Corporations Act provide creditors and directors with certainty about their rights and obligations, the Corporations Act sets out very few specialised rules regarding the administration of insolvent trusts or trustees. Instead, the administrations of such are determined by a mix of legislation, common law and equitable principles. The lack of clarity has led liquidators to resort often to the Court in order to obtain advice about the legality of future actions.

It is therefore not clear whether the legislative arrangements contained in the Corporations Act are adequate to maintain the confident participation of retail investors in [schemes] because of

deficiencies in the way the Act deals with: resolving the consequence, for otherwise viable schemes, of the insolvency of their RE; and what is to occur when the RE is insolvent and the scheme itself has failed. Informal stakeholder consultations have also raised issues with the general operation of the [schemes] regime, which has not been reviewed since 2001.

I request that CAMAC:

- examine whether the current statutory framework is adequate for the winding up of [schemes], and agribusinesses in particular, and whether it provides the necessary guidance for liquidators, creditors, investors and growers;
- advise what legislative amendments should be made if the current legislative framework does not provide the necessary legislative tools with respect to the arrangements for dealing with non-viable [schemes];
- examine whether the current temporary RE framework enables the transfer of viable scheme businesses where the original RE is under financial stress, and if not whether it should be reformed or replaced;
- examine whether REs are unable to restructure a financially viable [scheme] and advise if the current legislative methods available to companies under the Corporations Act should be adapted to managed schemes; and
- examine other proposals to improve Chapter 5C, including in relation to: convening scheme meetings; cross-guarantees entered into by REs on behalf of other group members; and statutory limited liability.