Submission to
CAMAC
Managed Investment
Schemes

Clarendon Lawyers
# Table of Contents

## 1 Introduction
- 1.1 Submission
- 1.2 Outline of Submission

## 2 Our Experience
- 2.1 Overview
- 2.2 Trust based MIS
- 2.3 Contract based MIS

## 3 General comments and observations on MIS and the Discussion Paper
- 3.1 Complex Group MIS
- 3.2 Members informational disadvantage
- 3.3 Members’ Rights
- 3.4 Significance of MIS industry and effect of reforms

## 4 Detailed Response to Discussion Paper
- 4.1 Overview
- 4.2 Chapter 2 – Current Position
- 4.3 Chapter 3 – Proposed key legislative reforms
- 4.4 Chapter 4 – Transfer of a Viable MIS
- 4.5 Chapter 5 – Restructuring a potentially viable MIS
- 4.6 Chapter 6 – Winding up a non viable MIS
- 4.7 Chapter 7 – Other matters

## 5 Other Matters
- 5.1 Additional issues facing MIS
- 5.2 Difficulties with replacement of an RE
- 5.3 Entrenching provisions
- 5.4 Section 173 – access to register of members
- 5.5 Compensation arrangements

### Schedule 1 – Cases

### Schedule 2 – Observations on failed agricultural MIS
1 Introduction

1.1 Submission

1.1.1 This submission is in response to the Corporations and Markets Advisory Committee's Managed Investment Schemes Discussion Paper (Discussion Paper).

1.2 Outline of Submission

1.2.1 There are a number of serious issues facing the future of managed investment schemes (MIS) and the MIS industry. A number of these shortcomings are identified and discussed in the Discussion Paper. In particular, we note the issues identified concerning the regulatory and statutory framework for dealing with distressed and/or insolvent responsible entities (REs) and MIS, which we consider requires careful and considered reform. However, there are a number of other issues facing the MIS industry which are not addressed in the Discussion Paper and which we submit must also be considered as part of any legislative reform.

1.2.2 A substantial portion of the Discussion Paper is concerned with the operation of MIS from the perspective of creditors. In our submission we have sought to amplify the perspective of members and REs and also bring into discussion the impacts of any reform on the broader investment community and financial services industry.

1.2.3 Similarly, much of the Discussion Paper appears to be responding to the difficulties faced by insolvency practitioners (which we refer to generally as 'liquidators') in the recent insolvencies of agricultural MIS (Agri MIS). In our submission, many of these difficulties arose from liquidators attempting to treat the MIS like companies and treat members like shareholders, operating as they were within the statutory insolvency regime applying to companies and the REs to which they were appointed.

1.2.4 Members of MIS have different rights to members of companies, and the differences between MIS and companies are a source of important diversity of investment opportunity in the financial services sector. In our view, this diversity should not be sacrificed in the interest of commercial certainty or simplicity for creditors. Steps to address the inadequacy of the current legislative insolvency regime in respect of MIS should acknowledge the fundamental elements of MIS and their differences to corporations, rather than attempt to dissolve the differences between an interest in an MIS and a share in company in order to reshape a square peg to fit into a round and, perhaps for some, convenient hole.

1.2.5 We agree that greater certainty for all parties is required to address the legal, structural and regulatory issues identified in the Discussion Paper and in this submission. We consider that all parties involved in the MIS industry would benefit from such certainty. However we consider that if any of these parties require greater protection, it is the unsophisticated and disparate members of MIS. We consider that the difficulties encountered in the aftermath of the collapse of Agri MIS will, to a large extent, be understood as a function of particular historic circumstances. Accordingly, we submit that reforms to the industry as a whole must be tempered by an awareness of their implications across the entire MIS and broader financial services industry, and not be focused solely upon curing ills in one sector at one time.

1.2.6 Our substantive submission is structured as follows:

a. Section 2 details our recent experience in relation to MIS;

b. Section 3 provides general comments and observations on MIS and the Discussion Paper based on our experience;

c. Section 4 provides a detailed response to each of Chapters 2 to 7 of the Discussion Paper; and

d. Section 5 provides detailed discussion of various matters raised in response to the final question in the Discussion Paper.
1.2.8 We hope that our contribution will provide an additional and useful perspective on the issues facing the MIS industry.

1.2.9 Should you have any queries regarding any aspect of our submission or require any further information please do not hesitate to contact Dan Mackay on 03 8681 4424 or at Dan.Mackay@clarendonlawyers.com.au.

1.2.10 The following defined terms are used in this submission:
   a. **Act** means *Corporations Act 2001*;
   b. **AFSL** means Australian Financial Services licence;
   c. **ASIC** means Australian Securities and Investments Commission;
   d. **ATO** means Australian Tax Office;
   e. **RE** means responsible entity; and
   f. **Regulations** means *Corporations Regulations 2001*.

1.2.11 Other terms are defined in context.

2 Our Experience

2.1 Overview

2.1.1 Clarendon Lawyers is a corporate and commercial law firm with significant experience in relation to MIS including establishment, restructures, takeovers and disputes.

2.1.2 We have acted for REs, financial advisors, retail and institutional investors and a number of investor representative groups. In doing so we have gained a unique perspective on issues facing the MIS industry from both the member and fund manager perspective.

2.1.3 In the last three years we have had extensive experience in matters relating to MIS. Our experience in related legal proceedings is detailed in Schedule 1. We have also been involved in a number of takeovers, restructures and refinancing of distressed trust based and contract based MIS.

2.2 Trust based MIS

2.2.1 As detailed in Schedule 1, Clarendon Lawyers has acted for:
   a. The trustee of the superannuation fund which instigated the dispute that was resolved in *ING Funds Management Ltd v ANZ Nominees Ltd; ING Funds Management Ltd v Professional Associations Superannuation Ltd* [2009] NSWSC 243; and
   b. Centuria Capital Limited (then Century Funds Management Limited) (Centuria) in relation to the replacement of Lachlan REIT Limited (a subsidiary of Becton Property Group) as responsible entity of two unlisted property trusts, the Becton Office Fund No 2 and Becton Diversified Direct Property Fund.

2.2.2 In addition, Clarendon Lawyers presently acts for a number of clients in respect of failed or distressed unlisted property trusts in matters which are not in the public domain. In these matters, we are investigating potential contraventions of the Act, law of trusts and general law by former and present responsible entities, with a view to obtaining compensation or recovering losses or trust property for the relevant MIS and/or its members.

2.3 Contract based MIS

2.3.1 As detailed in Schedule 1, Clarendon Lawyers has had significant involvement in matters relating to the collapse of Agri MIS.

2.3.2 Our work in this area has primarily involved acting for investor (grower) representative groups, namely Timbercorp Growers Group, Save My Trees & Save My Tiwi Trees Inc (Great Southern), Willmott Growers Group Inc, Rewards Growers Advocacy Group, and FEA Growers Group Inc.

2.3.3 The MIS in each of these matters were operated within a corporate group in which some or all of the members became financially distressed and/or insolvent, with contagion bringing about the collapse of
the Group. Issues we have observed in relation to such corporate group structures (what we term Complex Group MIS) are discussed at 3.1 below. As a result of group, or group member failure, all MIS operated by the Group have been imperilled and members are facing or have suffered substantial losses, even where the MIS of which they are members and/or the underlying assets are viable.

3 General comments and observations on MIS and the Discussion Paper

3.1 Complex Group MIS

3.1.1 In our experience the most complex and problematic issues have arisen in relation to agricultural MIS with a multi-function RE that is part of a corporate structure in which, typically, related parties of the RE provide contracted management services, own assets on which the agricultural activity occurs and/or provide finance to the group and members of various MIS within the group (Complex Group MIS)\(^1\).

3.1.2 In our experience, Complex Group MIS have involved a number of significant but largely unidentified and/or undisclosed risks. These have included group and/or related party cashflow (insolvency) risk, group finance risk, structural risk, legal and regulatory risk and contagion risk. A number of these risks are interrelated and result from complex and poorly understood structuring and documentation.

3.1.3 The incidence of complex and highly problematic legal issues is presently extremely high as a result of the cascading collapses of Agri MIS and their operators over the period 2008 to late 2010.

3.1.4 Many of these ‘complex legal issues’ have arisen because of structural flaws in complex and untested MIS structures and as a result of ‘financial engineering’ occurring within the prevailing taxation regime at the time of establishment. The potential consequences of these overly complex and over-engineered structures were largely unknown.

3.1.5 In the future, MIS establishment will be informed by the experiences of the past two years. Lawyers, accountants and corporate advisors will seek to avoid repeating the mistakes of a decade or so ago and seek to avoid unnecessary complexity or uncertainty of structure, and or provide contingencies for unexpected issues that may arise. Investors and advisors are likely to eschew overly complex structures.

3.1.6 We submit that caution should be taken in enacting wide-ranging legislative reform as a direct response to these extreme events. To the extent that they are an historical accident, far reaching reform to address them will be of limited utility if future structuring is properly informed by ‘lessons learnt’, whilst any adverse impacts of reforms on the MIS industry will be permanent.

3.2 Members informational disadvantage

3.2.1 Typically MIS, in particular Complex Group MIS, involve a number of participants – financiers who are large Australian and International banks, product issuers, operators and promoters, corporate advisors, top and mid tier legal advisors, ‘Big Four’ and mid tier accountants, financial advisors, investors and regulators - through administration of the corporate, financial services, and taxation laws that govern MIS, and more directly through the registration of MIS by ASIC and the issue of product rulings by the ATO.

3.2.2 Of all commercial participants, investors are the least sophisticated and are at the greatest informational disadvantage. As such, they are heavily reliant upon the proper functioning of the regulatory system. They are also reliant upon financial advisors and research houses, who themselves are at an informational disadvantage to participants on the ‘inside’.

3.2.3 It should also be noted that comparatively, as a group, it is investors who have suffered most as a result of the massive losses occasioned by the recent failures of MIS.

3.2.4 While market and economic factors were the initiating causes, the losses suffered by retail investors have been contributed to by failures of the disclosure regime, gatekeepers and financial services regulation.

---

\(^1\) See Bigmore QC, G and Neil Hannan *Issues arising out of winding up managed investment schemes* Insolvency Law Bulletin October 2010 42 for a succinct summary of the characteristics of such MIS.
3.2.5 Moreover, these losses are now being compounded by the reaction from the financial services industry, government and regulatory bodies, and the legal community to these investments and the position of investors in them.

3.2.6 Products are dismissed as toxic. Responses to the morass of legal difficulties have been overly pragmatic, often at the expense of members. Of even greater concern is an apparent increasing disregard for the position of investors in these products who have suffered or are suffering losses. This appears to be driven by a negative perception of these investors because of the tax-effectiveness of certain products and the apparent tax-driven nature of the original investment.

3.2.7 A few factors are important to note in this respect:

a. First, the drivers of a particular investment are varied. Generation of income, and generation, preservation and/or protection of capital are equally valid investment drivers. A long-term shareholding to generate capital and income, is just as valid an investment as an option or future to hedge currency risk, and equally valid as an MIS investment to preserve capital through access beneficial tax outcomes and generate income and capital over the life of the project;

b. Secondly, and perhaps most importantly, such negative perceptions ignore the fact that the forestry investments were an integral part of Plantations for Australia: The 2020 Vision, a strategic partnership between Federal, State and Territory governments and the plantation timber growing and processing industries. They also delivered significant ancillary benefits to other service industries in rural communities; and

c. Thirdly, while ATO Product Rulings give no assurance that products are commercially viable, viability of a project is a relevant factor to the ATO’s decision to give a Product Ruling.

3.2.8 Reforms to the MIS legislative framework should be informed by this reality.

3.2.9 If investors are to bear more risk than there needs to be much greater transparency with respect to relevant arrangements and documentation and the effectiveness of the disclosure regime.

3.2.10 Consideration must also be given to whether shifting risk to investors is an appropriate response to the failure of counterparties to manage credit risk with respect to REs. We submit that this would not be an appropriate response and would have a detrimental impact on the investment industry and the diversity of the Australian investment landscape.

3.3 Members’ Rights

3.3.1 Significant aspects of the Discussion Paper are concerned with the rights of creditors, and a number of the proposed reforms are aimed at enhancing their rights. In particular, chapters 2 and 3 are concerned with enhancing the rights of creditors against scheme assets and even against scheme members personally.

3.3.2 In contrast, the Discussion Paper contains little discussion of members’ rights, or proposals to directly enhance or protect those rights. The reality of the collapse of a number of significant Agri MIS for investors has been stark. Some investors have seen a small return from the sale of scheme assets in the winding up of the MIS. A large number have suffered total loss of investment.2 In no way could the outcome of the collapse of these MIS, or the practical application of the regulatory and legal regime governing MIS, be seen to favour investors as against other stakeholders.

3.3.3 It appears that the relative advantage in a winding up scenario of a beneficiary of a trust in comparison to a shareholder of a company is presented in the Discussion Paper as a basis for the reduction of a beneficiary’s rights in the event of an insolvency. We do not consider this to be a valid justification for elevating creditors’ rights and we are concerned that despite the significant impact of MIS failures on investors and the profound loss of invested capital, insufficient attention is being directed at the underlying issues from a members’ perspective.

3.3.4 We agree that greater certainty for all parties is required to address the legal, structural and regulatory issues identified in the Discussion Paper and in this submission. We consider that all parties involved in the MIS industry would benefit from such certainty. However we consider that if any of these parties

---

2 For example: members of the Great Southern Plantations 2007 project invested approximately $132 million. Land on which trees funded by their investment was growing was sold in early 2011 with no return to investors and they suffered total loss of investment.
require greater protection, it is the unsophisticated and disparate members and not sophisticated creditors.

3.4 Significance of MIS industry and effect of reforms

3.4.1 The size and complexity of the MIS industry is indicative of its importance as a capital provider to a number of key industries with the Australian economy and society. In addition, it provides important diversity in an investor's portfolio from the relatively saturated Australian equities market.

3.4.2 As we have noted above, the most complex and problematic issues have arisen during the recent spate of high profile collapses of agricultural Complex Group MIS. These cases have involved complex, novel and previously unforeseen issues.

3.4.3 It appears that the issues observed in these matters are a key driver of the Discussion Paper and underpin many of the proposed reforms.

3.4.4 What we submit must be acknowledged are the peculiar circumstances in which these MIS have collapsed and these issues crystallised – the relevant periods of the economic cycle, changes in the prevailing tax environment, drought, an acceleration in complexity of MIS structuring and the Global Financial Crisis. With time, and as development and structuring of Complex Group MIS is informed by the experiences of the last three years, it is likely that this period and the collapses it entailed will increasingly be viewed within its particular historical context.

3.4.5 Whilst these experiences must be utilised to improve and strengthen the legislative regime, at the same time, the desire to implement fundamental reforms with wide-ranging effects to the MIS industry must be tempered by the recognition that they are a response, at least in part, to ‘long tail’ events. The desire for wide-ranging reforms to target this extreme sample must be tempered by the recognition that fundamental changes to MIS will have potentially negative impacts on the MIS industry as a whole, and may be a direct response to historically isolated problems.

3.4.6 Any reforms to the law relating to MIS must bear in mind the MIS industry’s importance as a capital provider, and potential adverse impact reforms may have on the MIS industry’s ability to attract and deliver capital. If reforms are to be made which will have a detrimental effect on the MIS industry’s ability to attract investment, alternative source of capital for these industries must be identified, or there is a risk of negative outcomes for a number of industries and sectors.

3.4.7 We consider that certain potential reforms raised by the Discussion Paper would have a devastating effect on the funds management and MIS industry and seriously diminish the MIS industry’s capacity as a capital provider. In particular, we are greatly concerned by the potential negative impact of reforms which enhance the rights of creditors against scheme assets and which could result in scheme members being personally liable.

3.4.8 Such proposed reforms merely shift the burden of the credit risk of the RE as counterparty from creditors to members. No proper and considered justification for why this should happen is provided in the Discussion Paper.

4 Detailed Response to Discussion Paper

4.1 Overview

4.1.1 We provide the following detailed response to the Discussion Paper on a chapter by chapter basis commencing at chapter 2.

4.1.2 We have responded by reference to the relevant subject sections on which we comment, and in direct response to the proposed reforms and questions which we address.

4.2 Chapter 2 – Current Position

4.2.1 We make the following response to Chapter 2 of the Discussion Paper:

  2.2.2 Regulation of an MIS

   Replacement of the RE
We do not agree with the statement on page 17 of the Discussion Paper that the ostensible purpose of section 601FS of the Act is to ensure that the rights of creditors are not affected where the RE of an MIS changes. It is not borne out by inspection of the section and nor supported by paragraph 8.37 of the Explanatory Memorandum to the Managed Investments Bill 1997.

We refer to section 4.4 below where we discuss the purpose of sections 601FS and 601FT in response to the question posed in section 4.3 of the Discussion Paper.

2.2.3 The RE transacting as operator of an MIS

Rights of unsecured counterparties

We refer to the comment on page 22 of the Discussion Paper:

*In consequence, creditors have no access to scheme property in relation to transactions where the RE has acted in such a way that it has no right of indemnity against that property.*

This is an inherent risk for a counterparty to an agreement with an RE. While the crystallisation of these risks has led to significant observed losses by creditors of MIS recently (in particular in relation to Agri MIS) these risks were not unknown. They are an essential element of the counterparty risk presented by an RE and are based on sound trust law principles.

The indemnity and subrogation principles discussed are an incentive to a potential counterparty to satisfy itself that an RE has the power to enter into the contemplated transaction and has the necessary rights of indemnity. We note in this respect that MIS constitutions are publicly available and a commercial party engaging in a significant transaction with an RE would typically require copies of other documents including a PDS.

Removing this risk by extending the right of indemnification creates a moral hazard. Third parties could potentially be involved in breaches of RE duties with impunity. Such a position is inconsistent with existing provisions relating to persons being involved in the breach of an RE’s duties. Moreover, its effect would be to shift risk to members who, as discussed above, are least adequately resourced to understand and act according to such risks.

2.2.4 External controls

At page 23 the Discussion Paper notes the application of the takeover and compulsory acquisition provisions of the Act to the acquisition of interests in listed MIS and that attempts to entrench an RE of a listed MIS may amount to unacceptable circumstances for the purposes of Chapter 6. As noted above, there are no explicit prohibitions of entrenching provisions in relation to unlisted MIS. We consider this to be a gap in the law requiring statutory enactment to prohibit entrenchment, and discuss this further in section 5.3 below.

4.3 Chapter 3 – Proposed key legislative reforms

4.3.1 We make the following response to Chapter 3 of the Discussion Paper:

3.1 Need for legislative reforms

Our experience accords with the observation made on page 25 of the Discussion Paper regarding the entwinement of the affairs of MIS and the issues this causes.

Delay is an especially serious issue for MIS viability. Typically with a contract-based agricultural Complex Group MIS there will be various MIS with differing levels of viability. The insolvency of the RE will prevent maintenance of the plantations or crops while the external administration of the RE is conducted and the entanglement unwound.

As time passes without expenditure on the plantations or crops their condition and viability will naturally deteriorate. Viable MIS may become borderline, and borderline MIS unviable, detrimentally affecting the ability to replace the insolvent or distressed RE and continue the MIS.

3.3 Problems in practice

---

3 Subsections 601FC(5) and (6).
In our experience the most significant issues of the type identified on page 25 of the Discussion Paper arise in relation to Complex Group MIS, which may be either operated by ‘multi-function internal REs’ or ‘interconnected MISs’.

3.3.1 Need to identify the transactions attributable to each MIS

The absence of a statutory requirement to identify the capacity in which an RE transacts is a significant omission from the legislative framework and one requiring remedy.

However, the mere introduction of such a legislative requirement will not ensure compliance with it. There will continue to be REs who fail to identify the appropriate capacity, or incorrectly identify that capacity, when transacting. Disputes will still arise. In our opinion, the onus should remain on the party with whom the RE is transacting to satisfy itself that the RE is acting within its capacity as identified.

Many counterparties to arrangements with REs are highly sophisticated participants in the commercial system with significant assets at their disposal to assess credit risk of the RE. The onus must be placed on them to utilise the publicly available information and perform adequate ‘due diligence’ enquiries of the RE.

We suggest this could be achieved by the codification of a presumption, in the absence of clarity of the capacity in which an RE transacted, in favour of members in resolving any dispute or interpreting the effect of any document. Such a presumption would shift the burden onto the counterparty as well as the RE, and operate as a significant incentive to counterparties to ensure the propriety and clarity of transactions they undertake with REs.

In recognition that not all counterparties will be highly sophisticated investors, the presumption could apply to the extent the counterparty has taken reasonable steps commensurate with their size and sophistication and the size and complexity of the transaction.

3.4 Proposed legislative reforms

3.4.2 The proposed legislative reforms

Reform 1: Identification and recording of the affairs of each MIS

Questions

Should the policy approach in Reform 1 be enacted?

We support in principle the enactment of the policy approach in Reform 1.

We agree that the obligations outlined for REs for identification of agreements should be implemented.

We consider that failure to record an agreement should be an offence under the Act and responsibility for such failures should be extended to directors and compliance staff.

The compliance auditor should also be required to audit the agreements register on an annual basis and report any breaches or suspected breaches to ASIC.

We consider that the enactment of this reform should also place an onus on the counterparty to the agreement to satisfy itself that the RE has complied with its obligations for identification of agreements. Failure to take reasonable steps to satisfy itself may affect the counterparty’s ability to enforce the agreement or to seek compensation or damages in relation to it.

We consider that the Agreements Register should be available to members under similar provision to section 173 of the Act and available to the public on payment of a fee. Members’ access to particular agreements would then be governed by section 247A of the Act.

We submit that the Agreements Register should be lodged with and/or maintained by ASIC with copies of the underlying documents being lodged with ASIC electronically within a specified period after execution. The listing of documents lodged would then form a publicly available register. The documents underlying the ‘register’, whilst having been lodged with ASIC would not be accessible, but would form a central independent record of all agreements affecting MIS. This would also enhance ASIC’s ability to ensure compliance with the Corporations Law through access to the underlying documents.
Should the agreements register be a definitive statement of all agreements entered into by an RE as operator of a particular MIS?

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?

If no, what remedies should affected parties have? For instance, should a new RE have a right to claim against a former RE (or its officers) for any amount paid to a counterparty in consequence of the former RE not having registered an agreement, for which the new RE is now liable by virtue of s 601FS? This would have the effect of maintaining the liability of the former RE under an unrecorded agreement.

In a practical sense a ‘definitive’ register is attractive.

However, assuming the counterparty has undertaken reasonable enquiries to satisfy itself that the RE with whom it is transacting is doing so in a proper capacity it seems inappropriate to punish a counterparty for the RE’s failure to record the agreement as required.

Conversely, if the register were maintained by ASIC and publicly available, any counterparty could conduct a search at the expiration of a specified period. If the agreement were not lodged by then, the counterparty could approach the RE to ensure compliance and/or lodge a breach notice with ASIC which may have the affect of preserving the counterparty’s rights as if the agreement were recorded until such time as it is.

We agree that the RE’s failure to comply with its recording obligations shouldn’t jeopardise the members’ rights to benefits of that agreement. However, if the counterparty were afforded ability to address a failure to record the agreement this may reduce the risk posed to members.

We note that rights against a former RE, if that former RE is insolvent or under financial distress, will be largely worthless and ineffective.

Reform 2: use of scheme property

Questions

Should the policy approach in Reform 2 be enacted?

We strongly support enactment of Reform 2.

Should there be any exceptions to Reform 2? If so, in what circumstances and for what reasons?

We do not consider there should be any exceptions. Exceptions create considerable problems in the change of RE of one scheme and not the other. This has proved to be a fatal flaw in a number of Agri MIS where a single headlease covers multiple schemes, only some of which are viable. By way of example, in one matter in which we were involved, members of a viable MIS were unable to change the RE of the MIS because the receivers of the landlords threatened to terminate the shared lease for non-performance of obligations under the lease in relation to the non-viable schemes.

Reform 3: informing MIS creditors of a change of RE

Questions

Should the policy approach in Reform 3 be enacted?

We see no reason why this policy approach should not be enacted however we are unsure of what practical benefit it will achieve.

The RE of an MIS is information publicly available from ASIC. Counterparties can avail themselves of simple alert functions that would bring any change of RE to their attention. Further, it is highly likely that
parties providing services to the MIS under continuing agreements would be contacted by the RE prior to or following the change of RE.

It is unclear what practical benefit would be achieved by this notification process.

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

We refer to our comments above.

**Reform 4: rights of MIS creditors against scheme property**

**Questions**

**Should the policy approach in Reform 4 be enacted?**

Proposed Reform 4, as noted in the Discussion Paper, involves a fundamental change to the nature of trusts and MIS, however, the Discussion Paper provides little by way of explanation of the necessity or desirability for such a change or justification as to why such a profound alteration to the framework of MIS should occur.

Page 36 of the Discussion Paper states:

> At the time the MIS regime was introduced, collective investment schemes did not involve a large number of investors or members and did not involve significant amounts of money. Today, as a result of various factors discussed earlier, MISs have become a significant part of the economy and many schemes are large commercial enterprises. This may require a review of the legislative balance between the members of an MIS and its creditors.

Factual observations alone concerning the growth of the MIS industry do not provide a reason to effect fundamental reform of MIS.

Page 36 of the Discussion Paper further states:

> ...the reform would more closely align the rights of MIS creditors with those of corporate creditors.... It would benefit creditors of an MIS over MIS members. The rationale for this change is the typically commercial nature of investment as well as enterprise MISs.

(emphasis added)

The rationale appears to be that as MIS are growing in size and complexity, and can rival certain corporations, the same rights as those of corporate creditors should be given to MIS creditors, at the expense of members.

This rationale ignores the fundamental differences between trusts / MIS and corporations.

It also ignores the differences between the position of members of MIS and shareholders in a publicly listed company (the obvious alternative corporate investment vehicle for such investors).

A number of trust-based MIS, in which the RE transacts as principal, are unlisted. The RE of these MIS, unlike public listed companies, is not subject to continuous disclosure obligations, and members of these unlisted MIS are unable to trade their interests into a liquid market.

As we have noted above in section 3.2 above, in our opinion, members are at a significant disadvantage to other parties involved in MIS, and there is no justification for shifting responsibility for the credit risk posed by an RE to members form the counterparty.

Such suggested reforms ignore this disadvantage and seek to absolve counterparties from responsibility for their dealings in relation to MIS. The fact is that MIS are peculiar legal structures akin to trusts. It well understood that they are different from bodies corporate transacting on their own behalf, and that they transact subject to restrictions imposed by the constitution and other documents of the MIS.

MIS constitutions are publicly available. In our opinion, PDS and supplementary PDS should be required to be lodged with ASIC and made publicly available. Counterparties should investigate the terms of trust of the RE with whom they are considering transacting, both through enquiries of the RE and their own.

We refer to the following comment at page 29 of the Discussion Paper:
However, once an RE goes into external administration, the outcome where the RE cannot
make an indemnity claim is that the affected counterparties of the RE have no means of
recovery against the property of the MIS. On one view, such an outcome would constitute a
diminution of creditor rights that is out of step with the nature of many commercially based
MISs.

It goes on to contrast this scenario with the ‘indoor management’ rule for companies.

While the reduction of REs and trustees to the status of companies may create the benefit of simplicity
for creditors, we reiterate that we do not consider that this is a sufficient basis for doing so.

The rules relating to indemnification are an essential feature of a trust. It reflects the essential difference
between the interests of a beneficiary of a trust and a shareholder of a company. A shareholder has no
interest in a company’s property. It has merely a contractual right against the company (a chose in
action). A beneficiary has a proprietary right in property held on trust by a trustee. Because of the
beneficiary’s proprietary right, a trustee’s rights of indemnification out of trust property is necessarily
limited. This proprietary right is also the basis of different tax treatment to companies. These are well
established principles of law.

We reiterate our comments in relation to section 3.3.1 about the need for counterparties to take
responsibility for the credit risk they accept and conduct appropriate due diligence on the RE.

We can see no reason why the applicable restriction on a trustee’s right of indemnity where it has acted
beyond power or otherwise improperly against trust property should be removed. Such a change would
effect a fundamental change to the very nature of MIS. It should not be done without a broader
investigation into the role of MIS in the Australian economy.

From a policy perspective, it is unclear why the beneficiaries should bear the brunt of the RE’s breach of
trust rather than counterparties that are parties to the offending transaction. The counterparty has
discretion as to whether or not it will transact. It can investigate and undertake due diligence. The
members have no such control over their situation. Members have limited capacity to pursue REs for
compensation for losses. There is a clear imbalance in resources between an RE and a member, and
members’ access to external dispute resolution schemes is severely limited by the exclusion of
complaints relating to the ‘management of the fund or scheme as a whole’.

This discussion also raises the issue of the adequacy of professional indemnity and/or directors’ and
officers’ insurance policies held by REs, which we identify as a significant issue facing MIS and discuss
further in section 5.5 below.

An adequate regime of insurance cover would mitigate losses of counterparties where the RE
represented that it was acting within its right of indemnity but was not.

We do not think the law should be reformed to transfer credit risk to members. It would increase the risk
of investing in this sector such that it would become unviable, even with a substantially increased
minimum professional indemnity cover required of an RE.

We also refer to the comment at page 31 that:

The proposed legislative reforms seek to respond to the issues raised above, which can
significantly affect the operation of a viable, potentially viable and non-viable MIS.

We note that the Discussion Paper does not explain how the limitation on the rights of creditors to
recover against scheme property in circumstances where the RE has no right of indemnity ‘significantly
affect the operation of a viable, potentially viable and non-viable MIS.’

We also refer to the further comment at page 31:

These legislative reforms are also central to the process of treating MISs in a similar manner to
corporations.

---

4 Macaura v Northern Assurance Co Ltd [1925] AC 619 (HL Ir).
6 For example: cl5.1(i) of the Financial Ombudsman Service’s Terms of Reference.
There is little discussion in the Discussion Paper of why this process is appropriate or necessary. It is also not apparent in the Terms of Reference that this assumption is to be made by CAMAC. To the contrary, there appears to be an emphasis in the Terms of Reference on ensuring “the confident participation of retail investors in MIS”. Treating REs in a similar manner to companies would not achieve this.

Before such fundamental reform is contemplated we consider careful investigation of the potential impact of such reforms on the viability of the MIS industry, and in turn the diversity of investments available in the Australian market should be conducted, so that the full implications of such changes beyond simplification and certainty for creditors are properly understood. The Discussion Paper does not provide such analysis.

In summary, we strongly oppose enactment of Reform 4.

We consider that it will have a significant detrimental effect on the MIS industry and compromises the rights of members for the benefit of creditors, displaying an underlying bias for which no justification has been provided.

Should such an enactment be made we consider that the removal of the restriction should be subject to exceptions where:

- The creditor is on constructive notice of the breach of trust by the RE;
- the creditor has been wilfully blind to the breach of trust by the RE; and/or
- The creditor in transacting with the RE has failed to take reasonable steps to satisfy it that the RE is transacting within the terms of its trust.

Further, should the reform be enacted then the right of recovery against MIS property held on trust should be subject to exhaustion of any property held by the RE in its personal capacity.

**If so, should creditors of an MIS include all persons who have entered into an agreement with an RE as principal in its capacity as operator of a particular MIS or only those persons claiming under an agreement that has been recorded in the agreements register (as per Reform 1)?**

Subject to the exceptions detailed in the preceding section, the removal of the restriction should only apply to those appearing in the Agreements register, consistent with the matters raised in our response to Reform 1.

### 3.4.3 Application of the proposed legislative reforms

**General application**

Page 38 of the Discussion Paper states that:

*The proposed reforms are not intended to interfere with the usual practices for running a viable MIS. Rather, the aim is to ensure the clear and separate identification of the affairs of each MIS operated by a multi-function RE and the rights of creditors of each MIS.*

In our opinion, Reform 4 would do nothing to ensure the above.

Rather than ‘ensuring the rights of creditors’ what this reform would achieve is a significant expansion of the ability of creditors to recover.

Creditors’ rights are presently clear in that they are limited to the right of indemnity of the RE. The reform is fundamentally altering, rather than ‘clarifying’, these rights.

As noted, the reforms will have a significant impact on the participants in MIS under financial stress. That impact will primarily be borne by members. The reforms seek to break down the fundamental feature of MIS being the separation between the RE as trustee of the MIS and the MIS itself, such that parties transacting with the RE gain access to the trust, even where the terms or particulars of that transaction are beyond the trust.

No clear rationale has been provided for the fundamental alteration of creditors rights from derivative to direct as against the MIS.
There are vague references to the increasing similarity between MIS and corporate enterprises. However, beyond high level statements of this nature, there is no evidence provided as to this increased similarity, nor examples of such given. To the extent that this is anecdotally accurate, the actual prevalence of this confluence is unclear.

Irrespective of the prevalence or otherwise, there is no explanation of how this fact (if it is correct) warrants a fundamental change to the nature of MIS.

We also note that these proposed reforms are intended to apply to MIS where the RE does not contract as agent for the member, but transacts as principal (typically a trust based scheme). In our experience, the largest and most complex MIS have been contract-based MIS. Indeed, the most problematic collapses in respect of untangling members and creditors rights in relation to property have been the various high-profile agricultural Complex Group MIS, the majority of which are contract based schemes. We are concerned that the problems encountered in respect of these contract-based schemes may be driving proposed reforms such as Reform 4, despite the fact that Reform 4 would not address the issues in that context.

We think it would be beneficial for worked examples of instances where it is contended that this reform would address serious issues relating to distressed trust-based schemes to be developed and considered to assist assessment of the actual potential effectiveness of this proposed reform. In addition, quantitative and qualitative analysis of the size and nature of trust-based MIS, and rate and nature of failure, should underpin any such reform if it is to be enacted.

In addition, the relevant issue arises only where there has been a breach of trust by the RE. Breach of trust is the core issue. The suggested reforms appear designed to cure the negative impact of a breach of trust for counterparties transacting with the delinquent RE at the expense of members. We think a better solution would be aimed at addressing the underlying issue being the prevalence of breaches of trust. An effective and efficient framework for the enforcement of the law may be a preferable means of treating the cause rather than effect. This would place the onus on various participants to take responsibility, including ASIC, in addition to counterparties and other participants.

We also note in this respect that a member is at a significant disadvantage to counterparties (and other participants) to police the conduct of the RE and determine whether breaches of trust may be about to or have occurred. They do not have any knowledge or practical access to relevant documents. They don’t have the ability to conduct due diligence as a potential transactional counterparty does. This suggests the burden of ensuring the RE is acting within trust should remain with counterparties and the burden of failures remain with them also.

Finally, we note there is no obligation on counterparties to transact with MIS and assume the associated risks. Whether they do, is ultimately their business decision.

Application to service providers

If these reforms are to be enacted then we consider employees should have priority rights against the MIS as creditors for unpaid entitlements where those entitlements accrued in relation to work relating to the affairs of the MIS.

We note it is presently proposed that they be excluded from recovering against the MIS.

Creditor remedies against MIS members

We note that at present members of MIS (other than contract-based MIS where members are parties to agreements with third parties or the RE has transacted as agent) have no liability for any debts incurred by the RE – counterparties to such agreements have recourse only against the RE, and the RE only its right of indemnity against the MIS for liabilities properly incurred.

We oppose any change to this situation and strongly oppose Reform 4 as discussed below.

If the position remains as is, then we see no utility in a statutory limited liability for such members.

If the position were to change, such as proposed by Reform 4, we consider that statutory limited liability for members should be enacted.
3.5 Identifying scheme property

Questions

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

We consider this to be a worthwhile change, however, note that the accuracy or validity of such a register cannot be guaranteed.

We think consideration should be given to whether the RE should be required to lodge with ASIC, or alternatively, ASIC maintains such a register. As noted above, this would have the benefits of placing the relevant information into the hands of an independent party and would facilitate access to it.

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

We do not consider it is necessary to maintain the confidentiality of the register, as the information on the register would largely be publicly available albeit not through a single repository. Also, it is hard to see how a MIS could suffer from disclosure of such information.

We think a process similar to that provided by section 173 of the Act would be suitable.

As we note in section 5.4 below, we have encountered difficulties with REs failing to comply with valid requests made under section 173 of the Act. This can frustrate attempts by members to obtain relevant information and communicate with other members regarding the management of the MIS.

We note that if ASIC maintained the register it could provide copies of it to parties on the payment of the applicable fee removing the possibility of recalcitrance.

3.6 Identifying member transactions

Questions

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

We have observed in agricultural contract-based Complex Group MIS serious deficiency in the record keeping of the RE such that key contractual documents executed by members of by the RE as agent for members are unable to be located and doubt surrounds whether they were ever executed.

With this in mind we endorse an obligation on an RE to maintain a comprehensive register of all arrangements entered into by the RE as agent of the MIS members.

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

We refer to our comments above.

3.7 Tort claims and statutory liability

Questions

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

We consider it is necessary to clarify these circumstances.

Section 601FC is poorly drafted and has not been properly enforced in the registration of schemes. This has led to the ‘ponzi-like’ incidents in certain Agri MIS where all contributions are paid immediately as remuneration to the relevant RE, thus ceasing to be scheme property. This resulted in many Growers in later schemes incurring loans, paying planting fees which were lost on the insolvency of the group without trees ever being planted.

Errors in the drafting of section 601FC of the Act were previously highlighted by ASIC in their submission to the Review of the Managed Investments Act 1998.
The law in relation to a trustee’s rights of indemnity in case of breach of trust is complex and we consider that all stakeholders would benefit from statutory clarification consistent with trust law principles.

*In what circumstances, if any, and for what reasons, should tort claimants have direct rights against the property of an MIS?*

We consider that this is not appropriate in any circumstances or for any reason.

### 4.4 Chapter 4 – Transfer of a Viable MIS

4.4.1 We agree with the observations in the Discussion Paper regarding the difficulties posed by the uncertainty of liabilities that will be assumed by an RE and the need for due diligence (sometimes time-consuming) to be conducted.

4.4.2 We reiterate our support for Reform 1 to assist with this process and transparency of a MIS’s affairs. We also consider that implementation of a requirement that REs maintain a register of all agreements they execute as agent for members would also assist a potential TRE in assessing the role it would be assuming and in the process of seeking a replacement RE.

4.4.3 The Discussion Paper identifies a major problem in practice, being the difficulty with appointing a TRE to operate a viable scheme where the incumbent RE is in financial distress. The Discussion Paper notes that this is generally due to uncertainty on behalf of the potential TRE as to what liabilities it will be stepping into, and the necessity for the TRE to conduct substantial due diligence before taking any such ‘step’. The Discussion Paper also notes that other issues can arise in the process of changing an RE concerning the determination of what rights, obligations and liabilities will transfer to the RE, and also the remuneration rights of that entity.

4.4.4 A more fundamental threshold issue relates to the circumstances in which the TRE will be appointed. We note in this respect the inherent tension between a liquidator seeking to retire as RE and relinquish control of a MIS and its assets, and its duty to maximise returns for creditors.

4.4.5 The Discussion Paper focuses on a situation where a multi function RE comes into financial stress and certain of the schemes to which it is appointed are or may be viable. It is important to note the fundamental conflict that can arise for insolvency practitioners appointed to the RE’s of Complex Group MIS and related entities in the corporate group. The reality in practice is that with the majority of entities in the group insolvent and where there is cross-collateralisation amongst the members of the group and the RE or REs within the group, assets essential to the operation of the MIS, whether or not they are scheme property, are an important potential source of recovery for the creditors of the group.

4.4.6 This is important to note at the outset because of its relevance to the means by which a TRE may be appointed and by whom.

4.4.7 We make the following response to Chapter 4 of the Discussion Paper:

#### 4.2 Changing the RE

4.2.2 *Where application can be made for appointment of a TRE*

*Voluntary retirement of the RE & Ineligibility to remain as RE*

We suggest that where the RE has been placed in external administration it should be open for the administrator to apply to the court for appointment of a TRE.

*General provision*

We note the observations in the Discussion Paper regarding the uncertain ambit of this provision.

4.2.3 *Where application cannot be made for appointment of a TRE*

*Dismissal of the RE by the members*

Obtaining the requisite votes to pass an extraordinary resolution to remove an RE is an onerous task and is rarely undertaken without the consent of a replacement RE having already been obtained. In most cases, it is the replacement RE who underpins the campaign for their appointment.
We acknowledge, however, the ‘catch 22’ this places members in, especially in terms of the observed difficulties with the conduct of due diligence by a potential replacement RE.

The onus must remain on members to consider the future of the MIS before commencing a process for removal of the RE. Any circumstances promoting the removal of an RE without a replacement RE or TRE being appointed at the same time should be discouraged because of the uncertainty and disruption this places on the MIS.\(^7\) Winding-up by default in this circumstance should be avoided.\(^8\)

If reforms as discussed in the Discussion Paper regarding the position of TREs in respect of the liabilities of MIS to which they may be appointed are enacted then we consider it will be easier for members to obtain consent from a party to act as TRE than it would be to obtain consent to become replacement RE. This is a desirable outcome.

We raise for consideration the question of whether members should be able to remove the RE of a MIS and appoint a TRE by voting at a meeting. Such provision would appear to address the anomaly where the requisite threshold level of members support removal of the current RE, no replacement RE is available (most likely because of the issues identified in section 4.1 of the Discussion Paper), a TRE has consented to appointment but the members are unable to effect this change through the meeting process.

However, there are problems with a potential power for members to appoint a TRE.

It is likely resort to court will be necessary either before or after the meeting. A court application is likely to be required subsequent to the members’ meeting to validate certain terms of the appointment relating to remuneration and, more significantly, to address the status of the liabilities incurred by the former RE in respect of the TRE’s appointment (as discussed in our response to section 4.4.2 of the Discussion Paper below). It may be that the TRE’s consent and appointment is conditional on the court approving the proposed remuneration and liability position. This means that uncertainty remains until court validation occurs, if it does.

It may be that if members are to have such a right to replace the RE with a TRE, court approval for the appointment and its terms must first be obtained before proceeding to the meeting.

Prior court approval would seem a more attractive a proposition than post meeting application to the court with the uncertainty that entails, however, we note the expense of the court process and the potential for the prior court approval process in some cases to become a ‘battleground’ between the proponents of the appointment, the TRE and the incumbent in the pre meeting period.

It should also be acknowledged that reforms to simplify the process for appointment of TREs and reduce the risks associated with such appointment may, because of natural conservatism on behalf of prospective REs, lead to them consenting only to become TRE with a view to later appointment as RE if adverse issues are not identified in the TRE period, resulting in the appointment of TREs in circumstances where an interim or caretaker period may not actually be necessary.

**Questions**

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

We consider that the current threshold of an extraordinary resolution for removal of an RE of an unlisted MIS is too high.

We consider it should be replaced with a requirement of a special resolution, which at least 25% of votes that may be cast by members at the meeting have been voted in favour of.

We discuss in further detail below the difficulties facing members of unlisted MIS in removing and replacing the RE of a MIS, including the difficulties posed by the requirement for extraordinary resolutions.

We submit that in order to achieve effective member engagement and influence of a MIS’s management and direction (through control of the RE) it should be lowered as we describe above.

\(^7\) The uncertainty and disruption to an MIS caused when there is an urgent legal challenge to the validity of the convening of a meeting or passage of resolutions at that meeting for removal and replacement of the incumbent RE is analogous.

\(^8\) If the intention of the members is to have the scheme wound up they can put such a resolution to a meeting and if passed the RE is obliged to do so.
**What changes, if any, should be made to the powers of the court to appoint a TRE and why?**

We consider that express provision should be made in the Act for appointment of a TRE by the court where:

- The RE, a member or ASIC has applied for the appointment on the basis that the application is necessary to protect scheme property or is in the interests of members; and
- The court considers the appointment is necessary to protect scheme property, or is in the interests of members.

We also refer to our discussion above regarding the potential for members to seek to appoint a TRE.

We agree with the comment in footnote 112 of the Discussion Paper that doubt exists in relation to regulation 5C.2.02 of the Regulations.

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

In theory, an incumbent RE should assist a potential replacement RE to conduct due diligence, consistent with its obligations under subsection 601FC(1)(c) of the Act. In reality, as observed by the Honourable Justice Judd of the Victorian Supreme Court in *Lachlan Reit Limited v Garnaut & Ors*, an incumbent RE facing its removal is in a position of ‘profound, irreconcilable conflict’. In our experience, despite an incumbent RE’s duties under the Act, that incumbent will do as little as possible to assist a potential replacement RE with due diligence. Often the confidential nature of documents and relationships will be relied upon by the incumbent RE to prevent production or inspection, or to prevent the potential replacement RE from entering into discussions with counterparties to agreements with the RE, typically a financier. We refer to our comments at paragraph 5.2.6 below and to our response to section 4.7 of the Discussion Paper below.

We also note there is a genuine tension in requiring an incumbent RE to assist with the process of its own potential removal, beyond passivity in the process.

There is also a need to prevent spurious investigations or ‘tyre-kicking’ by predatory fund managers looking for over-capitalised MIS which can cause unnecessary expense to the MIS and distraction for the RE.

We anticipate that some of this conflict could be resolved through the implementation of reform 1 and a statutory process for access to certain documents.

In addition, a general power conferred on the court to order an RE to do anything the court considers appropriate in the interests of members in respect of due diligence by a potential replacement may be beneficial.

For example, in a situation where the incumbent RE is refusing to consent to the potential replacement entering into discussion with a financier (and where there is a inhibitive ‘event of default’ clause in the facility) regarding their attitude to replacement, application could be made to the court for an order that the incumbent RE consent and ancillary orders that the confidence of the arrangement be maintained by the potential replacement.

**4.4 Issues concerning the TRE**

**4.4.1 Eligibility to be a TRE**

**Question**

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

We refer to section 601FQ of the Act and note that a TRE’s role is essentially that of attempting to effect an MIS ‘workout’. This could involve simple transitional duties of conducting due diligence and facilitating a replacement or a more involved assessment of the MIS and its potential viability.

---

9 [2010] VSC 399 at [27].
Insolvency practitioners with experience in MIS and the relevant underlying industry of the MIS are well placed to conduct this role and we consider that eligibility criteria should be adjusted to account for the ‘workout’ aspect and the availability of skilled practitioners.

At the same time, however, we do not think it appropriate to extend TRE beyond the framework of the AFSL regime. We think it is important that an entity acting and transacting as RE be maintained within this framework.

We propose that the AFSL regime be modified to provide for AFSLs to be granted to entities authorising them to act as TRES of certain types of MIS.

Such authorisations could recognise the interim and ‘caretaker’ nature of the TRE role and its ‘workout’ element. Lower thresholds could be applied to entities seeking only a limited authorisation to operate as TRE of certain classes of MIS. Such AFSLs should be available to suitably qualified entities beyond the traditional fund manager paradigm, in particular insolvency practitioners. We also consider that the application process for a limited TRE AFSL could be streamlined to reduce cost and administrative burden in recognition of the specific role to be undertaken.

Obviously, a TRE authorisation could be obtained by any suitably qualified existing AFSL holder who already has authorisation to operate MIS as RE.

In some cases a ‘full-service’ and established fund manager would be the most appropriate TRE. In other cases, potentially of high distress of the former RE or questions as to viability of the MIS, a limited function TRE with workout skills and experience would be more appropriate.

This change would allow the pool of candidates to be widened to utilise a wider skill set and provide flexibility whilst maintaining the integrity of the regulatory regime for operators of MIS, and avoiding the considerable costs incurred by insolvency practitioners, claimed against scheme property by way of a lien and ratified by the courts.10

4.4.2 Outstanding obligations and liabilities of the outgoing RE

Question

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?

Election by the TRE

We consider the process of election is unlikely to work in practice. On what basis would a TRE elect which liabilities it would be bound by? On what basis should it choose between creditors which have access to MIS assets through it? Does this preference afford priority in practice? Presumably, they would elect liabilities to the limit of the indemnity provided by the MIS assets and this would appear to devolve into the Limited Liability option. Inherent conservatism is likely to result in liabilities not being elected if there is any doubt surrounding them or the limit of the indemnity. What if the TRE chooses a liability which it turns out was not properly incurred and for which the TRE can have no recourse to MIS assets whilst a different liability properly incurred may have been relegated to a claim against the former RE due to its non-election.

In addition to these practical difficulties we consider it will result in delay and, for the period of such delay, uncertainty.

Limited liability of incoming TRE

This proposal is more practical, however, we note the following potential issue.

In many circumstances where a TRE is appointed the outgoing RE will be under financial distress. If this policy proposal is implemented, it could lead to a ‘race to the bottom’ by creditors concerned they will be relegated to claiming against the distressed or insolvent RE where there are insufficient assets remaining to satisfy its indemnity (after satisfaction of liabilities incurred by the TRE), resulting in creditors seeking to enforce securities or otherwise recover liabilities against the TRE. This could

10 For example, Thackray & Ors v Gunns Plantations Limited & Ors [2011] VSC 380 (11 August 2011), where a lien of almost $14 million was approved in relation to 10 MIS.
destabilise the MIS and the TRE and cause significant distraction to the TRE due to involvement in litigation. A form of moratorium may be a necessary adjunct to such a policy.

**Court power**

We are concerned that utilising a court process for determining these issues would be complex, time-consuming and costly.

It may be that in particularly complex circumstances application can be made to the court for orders under the existing (or any amended) general power of the court, however, we do not consider that this should be the starting point.

**Moratorium**

We support this policy initiative.

We do not consider the argument against it, noted in the Discussion Paper compelling. In many circumstances it is unclear whether a MIS is viable or in what circumstances it is viable. The TRE approach is in the interests of both members and creditors given that it seeks to maximise the prospects of continuing a scheme rather than liquidation, which is likely to lead to a shortfall to creditors.

4.4.3 **Duties of the TRE**

**Question**

*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?*

We agree that a process by which the TRE is required to review and remedy the entire compliance framework of the former RE and the MIS is unduly burdensome and counterproductive given the nature of the TRE’s role.

In relation to the identified policy option of the court adjusting statutory duties of the TRE and its officers, we consider this too may be overly burdensome on the TRE and the court and may necessitate a mini-compliance review in advance of appointment, and further applications for relief after appointment as issues come to light.

An alternative approach would be to absolve the TRE for a specified period (ordinarily the period of their appointment except in exceptional circumstances where the appointment was inordinately lengthy) from liability under statutory duties to the extent they were pre-existing at the time of their appointment.

If the period of appointment was extended or became lengthy then limited remedial work could be required by the court as a requirement of extension (ie to mitigate risks).

4.4.4 **Remuneration of the TRE**

**Question**

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

We support the implementation of statutory or other provision regarding the remuneration of TRES which will promote willingness of parties to be appointed TRE.

For this reason, we support giving the court explicit power to make orders regarding the TRE’s remuneration including approval of rates.

We also question whether consideration should be given to priority payment of TRE fees in any subsequent winding-up, similar to that provided to liquidators, provided that those fees were reasonably and necessarily incurred in their appointment.

This would provide TRES with comfort that their fees would be met in cases where the viability or solvency of the MIS was in question (and where, arguably, a TRE may be most required).

We would envisage a process whereby court approval of rates was required before or at the time of appointment, and subsequent court approval of the payment of fees and expenses prior to their payment.
Alternatively, s601GA could be amended to require a scheme constitution to contain provisions not only in relation to the winding up of the scheme but also in relation to funding if a TRE is appointed to the scheme.

4.4.5 The role of the TRE in relation to the future of the MIS

Questions

Are any changes regarding the role of the TRE in the future of the MIS 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:

- possible conflicts of interest faced by the TRE
- the interaction between the TRE provisions and a procedure for voluntary administration of an MIS (if introduced)
- a TRE providing assistance to an external administrator?

Conflict of interest

If the eligibility requirements to act as a TRE are amended as outlined in our response above to the question posed in section 4.4.1 of the Discussion Paper then we consider there will be, broadly speaking, two types of TRE appointment:

- TREs who assume the role to undertake a primarily ‘caretaker’ or ‘workout’ function with no desire to be appointed RE at the end of temporary appointment. There is no conflict issues in this scenario; and
- TREs who assume the role with a desire to transition to appointment as RE.

There is a potential for a conflict of interest to arise as outlined in the Discussion Paper in relation to the second scenario. However, in light of the obvious benefits of facilitating the TRE appointment process, in our opinion that risk must be accepted and mechanisms put in place to attempt to manage or mitigate that risk.

Express provision could be inserted into the Act requiring TREs to take all reasonable steps to facilitate the identification of and consideration by members of alternative REs, including assisting potential replacement REs in conducting due diligence.

Through court appointment, if necessary, orders to this effect could be made.

In addition, a dissatisfied potential replacement RE, member or ASIC could apply to the court for orders as required to facilitate compliance with this obligation.

Alternation of eligibility requirements may lead to more appointments by ‘caretaker’ or ‘workout’ TREs to facilitate a process and fund manager or full service REs who desire to become replacement RE may be content to allow such an appointment to occur and utilise access to information via the TRE to develop a replacement proposal for members to consider.

Interaction with VA for MIS

We consider that a TRE is best placed to understand and act upon the particular circumstances of the MIS and should have a role in the appointment of an MIS administrator.

There are circumstances where the TRE is perfectly placed to make the appointment on its own initiative, and in such cases the court process would be an unnecessary delay and cost. Conversely, there are also circumstances in which a unilateral appointment may be inappropriate.

There is merit in both unilateral and court-ordered appointment.

If the TRE is granted unilateral rights then the TRE should be subject to legislative constraints similar to those provided by subsection 436B(1) of the Act. In addition, it may be appropriate for a TRE to have a right of appointment where it thinks the MIS’s purpose cannot be achieved.
We strongly support a restriction in the form of subsection 436B(2) of the Act in this respect to avoid risk of conflict affecting the MIS administrator appointment process.

4.5 Matters covered in the transfer of rights, obligations and liabilities

**Question**

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

The effect of sections 601FS and 601FT of the Act are extremely important in relation to the restructure and continuation of MIS, in particular where legal or equitable rights of a former RE are intrinsic to a replacement RE’s ability to continue the MIS. However, there is uncertainty as to the effect of these sections.

**Scope of novation**


> 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.


> 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 registration.

In contrast, in the recent decision of the Victorian Supreme Court in *Primary RE Ltd v Great Southern Property Holdings Ltd & Ors (recs & mgrs apptd) (in liq)* [2011] VSC 242 (*Primary RE Ltd*), Honourable Justice Judd held at [178]:

> To extend the scope of operation of s 601FS and 601FT, to substitute a new Responsible Entity as a party to a validly terminated agreement would, in my view, require clear words. Section 601FT should, in my view, be construed so as to confine its operation to operative agreements, extant at the time of the change in Responsible Entity. If there are rights after termination, they may be captured under s 601FS.

In reaching this decision, Judd J observed:

> Primary alleged that as a consequence of its appointment as Responsible Entity for the 2007 Scheme, it became entitled to the ‘rights, obligations and liabilities’ of the tenant in relation to the 2007 Scheme. That much is obviously correct. It went on to submit that it had the right to attack the validity of the notices of default and termination, and to claim relief against forfeiture in the event that the terminations were upheld.

> ... The issue in this part of the case is whether the Corporations Act provisions had the effect of transferring to Primary any ‘right’ that the tenant might have had to apply for relief against forfeiture. If the tenant’s opportunity to make such an application was a ‘right’ capable of transfer by reason of the operation of the Corporations Act provisions, did such a right exist in the circumstances of this case?

---

11 *Primary RE Ltd* at [168]; [170]; [172-4]; [179].
The landlords submitted that the right to make application for relief against forfeiture was not a 'right' that transferred under s 601FS. They submitted that it was a bare, unassignable, right to sue, and in the absence of clear words, should not be included amongst other well recognised rights of a Responsible Entity. They submitted that whatever be the scope of the word 'rights' in s 601FS, it did not include the bare right to litigate.

The landlords contrasted the use of the term 'rights' in s 601FS with other provisions in the Corporations Act, where that word was used and followed by words of expansion. The definitions of 'interest' and 'managed investment scheme' in s 9 are examples. They also referred to s 413(4) which provides,

"liabilities" includes duties of any description, including duties that are of a personal character or are incapable under the general law of being assigned or performed vicariously.

"property" includes rights and powers of any description, including rights and powers that are of a personal character and are incapable under the general law of being assigned or performed vicariously.

The definition of 'property', in the context of a provision to facilitate reconstruction and amalgamation of companies and groups, extended the concept of rights and powers in a manner which deliberately and expressly included rights and powers that were of a personal character, incapable under the general law of being assigned or performed vicariously. The landlords submitted that such an extension provided an example of what would be required to express a legislative intention that any right to make application for relief against forfeiture would transfer under s 601FS.

... To extend the scope of operation of s 601FS and 601FT, to substitute a new Responsible Entity as a party to a validly terminated agreement would, in my view, require clear words. Section 601FT should, in my view, be construed so as to confine its operation to operative agreements, extant at the time of the change in Responsible Entity. If there are rights after termination, they may be captured under s 601FS.

I am of the opinion that the opportunity to apply to the court for relief against forfeiture under s 146(2), and the related provisions in each State, is confined to the person against whom the 'lessor is proceeding, by action or otherwise, to enforce or has enforced without the aid of a court...' a right of re-entry or forfeiture. The landlords took no such step against Primary and the tenant took no step to obtain relief, and is not an applicant for relief in this proceeding. The extended meaning of 'lessee' in s 146(5) does not assist Primary. As Primary did not assume the position of lessee under the terminated leases, it is not in a position to rely upon s 146(2) to make its application.

We consider, in order to achieve the purpose of sections 601FS and 601FT as identified by Rares J in Huntley, 'rights' should include 'rights' of the nature considered by Judd J in Primary RE Ltd. We consider that the legislation should be either amended with 'clear words' expressly including such rights within the ambit of sections 601FS and 601FT, or preferably be amended to reinforce the breadth to be given to the meaning of those words.

We think it is important that the uncertainty evidenced by the contrast between the above decisions be clarified to facilitate replacement and continuation of MIS, in particular those in distress or adversely affected by the collapse of the corporate group to which their RE belongs or the insolvency of their RE. We also consider that amendments could be made to clarify the interaction of sections 601FS and FT and the extent to which the principle stated in Australian Olive Holdings Pty Limited v Huntley Management Limited, in the matter of Huntley Management Limited [2009] FCA 1479 at [85] and approved on appeal is applicable. The principle is that the 'rights, obligations and liabilities' referred to in section 601FS of the Act are limited to those capable of having effect after a change of RE, as reflected in the language of subsection 601FT(1)(b) of the Act. There is potential for the application of
this principle to be inconsistent with the operation of subsection 1336(3) of the Act.\(^{12}\) It also could be applied to the considerable disadvantage of investors in circumstances where an RE has mixed scheme property across different schemes. A classic example of this is where an RE has entered into a lease in respect of multiple schemes. If there is a change of RE in one of the affected schemes, the law should clearly provide for division of the lease.

Finally, amendments should be made to clarify the effect of subsection 601FS(2)(d) of the Act. The issue identified in *Stacks Managed Investments Ltd* is referred to on page 52 of the Discussion Paper. However a further uncertainty arises regarding whether ‘could not have been indemnified out of the scheme property’ refers to a right alone or both a right and a financial capacity (ie whether there was sufficient scheme property for the indemnity to be satisfied).

**Purpose**

In properly interpreting the effect of sections 601FS and 601FT of the Act it is important to understand their purpose.

On page 17 of the Discussion Paper it states:

*Where an RE is replaced, the rights, obligations and liabilities of the outgoing RE are transferred to the incoming RE (including any TRE) through a statutory novation process. The ostensible purpose of this provision is to ensure that the rights of creditors are not affected where the RE of an MIS changes.*

Similar comments are made elsewhere in the Discussion Paper.

In our opinion, the purpose of these provisions is to ensure the effective continuation of the MIS after a change of RE – to ensure the continuity of the legal and contractual relationships which underpin the MIS. This extends to all relationships, including those involving members and creditors, with the MIS and its RE. In contrast to comments in the Discussion Paper as to their purpose, we do not consider they are intended to elevate one class of relationship above another, nor specifically to protect the rights of creditors above those of others.

Such an interpretation is consistent with the comments of Barrett J in *Investa* at [11] and Rares J in *Huntley* at [45] cited above.

We note that the Explanatory Memorandum to the *Managed Investments Bill 1997*,\(^{13}\) and other secondary materials, are of limited utility in assessing the intended purpose of enactment of these sections.

**Potential reform**

Any legislative reform to clarify the effect of sections 601FS and 601FT of the Act must carefully consider the intended purpose of those provisions, and bear this in mind when the effect of the reform on all parties involved or connected with an MIS are considered.

### 4.6 Remuneration where RE replaced

**Question**

*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?*

Based on our experience in a number of matters we are extremely concerned by the potential for entrenching provisions to restrict members’ practical ability to change RE or to create uncertainty surrounding a change such as to discourage a potential RE from consent to appointment or members from seeking to exercise their statutory rights.

\(^{12}\) Refer to the statement by Rares J in *Huntley Management Limited v Timbercorp Securities Limited* [2010] FCA 576 at [44] “... any property right requiring registration, such as in Torrens title land, held by the former responsible entity will vest in equity in the new responsible entity immediately on the creation of the newASIC record by force of Div 3 of Pt 5C.2, but will only vest in law when it is registered (see s 1336(3)).”

\(^{13}\) Section 8.37 of the Explanatory Memorandum states, in respect of section 601FS: ‘The purpose of the section is to ensure that the former entity has the right to be reimbursed for expenses properly outlaid, or liabilities incurred, on behalf of the scheme’. This explains the purpose of section 601FS(2)(b), however, does not assist in determining the legislative intention behind section 601FS(1).
We discuss entrenching provision in detail in section 5.3 below.

We consider that the type of financial arrangements discussed in section 4.4 and considered in Huntley and Saker, in the matter of Great Southern Managers Australia Ltd (receivers and managers appointed) (in liquidation) [2010] FCA 1080 are in effect entrenching provisions and discourage exercise of members’ statutory rights. As we discuss in section 5.3 below, we believe explicit prohibitions on entrenchment, in particular in relation to RE fees, should be included in the Act.

We submit that this should include express prohibition on RE fees being paid in advance.

4.7 Arrangements between an RE and external parties

Question

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

We have observed a number of MIS with finance facilities under which either the calling of a members’ meeting to consider the removal and replacement of the RE, or the passage of such resolutions, is an event of default under the facility. Such mechanism present a structural inhibition to a change of RE and discourage exercise of members’ rights because of the risk at which exercise of those rights would place the assets of the MIS.

Such mechanisms have also been heavily relied upon by incumbent REs in defending a hostile replacement of them as RE.

At first instance it appears easy to understand why a financier needs to be able to determine who it is lending money to. However, in most of the cases we have observed recourse under security for the facility is limited to the RE’s indemnity from the MIS, rendering irrelevant the replacement RE’s financial capacity as a directly relevant matter for the financier. In response, it could be argued that as in the event of default the financier must recover from the MIS’s assets, it should be able to withdraw finance if it is not satisfied of the replacement RE’s credentials to manage and maintain those assets.

What we have observed in practice is that typically it is a stable and well capitalised manager (RE), often with a proven track record in managing enterprises of the nature of the relevant MIS, that is being proposed to replace a distressed RE and/or an RE who is underperforming in managing the MIS. The replacement is often better credentialed and presents a lower risk to the financier than the incumbent.

In matters with which we have been involved or have observed where there have been inhibitive default clauses, the financier has not exercised its security upon the technical event of default, but has stood passive during the lead up to the meeting. Following replacement the financier has willingly negotiated regarding extension or refinancing with the replacement RE.

This fact may seem to suggest that in reality such clauses are not a significant hindrance to a change of RE. However, there will always remain the risk of exercise of security.

In addition, the technical ‘event of default’ has been used by incumbent REs during the ‘dialogue’ in the lead up to the meeting to argue against their replacement and as a basis for characterising the actions of the requisitioning members and proposed replacement as high risk and/or reckless. See for example, communications made by Opus Capital Limited (Opus) to members of the Opus Income & Capital Fund No 21 (Opus 21) in relation to Centuria’s proposed replacement of Opus as Opus 21’s RE.

We consider that entry into agreements which place indirect restrictions on the exercise of members’ statutory rights is inconsistent with an RE’s obligations under section 601FC of the Act. Notwithstanding the legality or otherwise of such agreements, they have been readily entered into.

We submit such agreements present a significant disincentive and practical impediment to replacement of an RE of a MIS and should be explicitly prohibited in the Act.

4.5 Chapter 5 – Restructuring a potentially viable MIS

4.5.1 At outset, we reiterate that speed is a critical factor in the potential workout or restructure of distressed MIS. All MIS, in particular Agri MIS, will suffer asset decay if funds are not available for or cannot be expended on maintenance of assets for an extended period.
4.5.2 In a number of the collapsed Agri MIS matters with which we have been involved we have observed viable or potentially viable MIS decay over the extended period of the administration of the RE and/or its liquidation, to such a point where the MIS are no longer viable or sufficiently viable for a restructure to be completed or winding up resisted. In addition, failure to maintain assets leads to significant breaches of covenants under contractual documents adversely affecting members’ rights.14

4.5.3 For these reasons, any process implemented to facilitate restructuring of potentially viable MIS must attempt to address the issue of delay and decay, either by ensuring the process is efficient or other measures can be taken to maintain assets whilst the process is completed.

4.5.4 We also note the observation at page 74 in the discussion paper that:

...many of the issues arising from the rights of members in contract-based MISs can currently only be solved, if at all, by court applications that raise complex legal problems.

4.5.5 It is important to acknowledge that the ‘complex legal problems’ raised by these contract based schemes are the result of overly complex structures of the scheme and related arrangements, as discussed at section 3.1 above.

4.5.6 We make the following response to Chapter 5 of the Discussion Paper:

5.4.7 New RE

Questions

Is there support in principle for the concept of a VA for an MIS?

We support in principle the concept of a VA for MIS.

We strongly support the application of a wider moratorium to protect members’ proprietary interests from the actions of third parties. In our experience, actions such as the termination of head leases have had irreparable effects on the ability of a potentially viable scheme to be restructured and continued.15

The Discussion Paper observes the potential for a draft MIS deed proposed by an MIS administrator to provide for postponement or compromise of the proprietary or contractual rights of members or related third parties, and could provide for a compromise of distribution or other rights that members may have as contributors to the scheme.

We assume that such compromise would be in addition to suitable compromise of creditors’ claims and that it is not envisaged that the MIS deed would provide a means for certain classes to effect a compromise of other classes’ rights for their benefit in the VA.

Should the VA of an MIS be able to apply to classes of persons other than creditors of the MIS?

What types of matters concerning these parties should be included in the VA of an MIS?

We submit that an MIS VA should apply to a broader range of persons connected with the MIS in order to make the VA procedure as effective as possible, and to avoid it being frustrated by actions of persons connected with the MIS but outside the scope of the VA procedure.

We consider the MIS VA should apply to:

- Creditors of the MIS;16
- Members holding proprietary or contractual rights;

---

14 For example: failure to maintain firebreaks constituted serious breaches of lease agreements.
15 See for example Primary RE Ltd.
16 We do not support Reform 4 and the right of creditors of the RE to claim directly against scheme property. The characteristics of ‘creditors of the MIS’ is therefore complicated. Essentially, they are creditors of the RE of the MIS in respect of whose debt the RE has a right of indemnification out of scheme property. Their role in an MIS VA would necessarily be based on claims lodged in this fashion – on the expectation of their subrogation of the RE’s right to claim against the MIS. It would be necessary for the MIS administrator to assess such claims. We do not use the term MIS creditors in the manner it appears the Discussion Paper does, namely envisaging persons who transacted with the RE and who by virtue of Reform 4 have direct claims against the scheme property.
- Certain affected third parties who have an interest in the subject matter of the MIS or claims
  against the RE as operator of the MIS, members, or property which may be scheme property; and
- All other members.

We are concerned that if members are not included in the VA process there is a risk that their rights
might be ‘sidestepped’, and may be altered or affected without their having any ability to influence the
VA, whilst a moratorium prevented them from seeking to exercise their statutory rights or protect their
rights in court.

We are concerned that such a moratorium, in circumstances where all members are not included in the
VA process, could unreasonably curtail members rights and ability to influence the future of the MIS,
and the VA process could be used as a means of stifling members’ and facilitating changes which may
be adverse to members’ rights or interests.

If all members are not included in the process, we submit other means of ensuring members have direct
representation in the VA process must be considered. One suggestion is establishment of a committee
of members who have an oversight and representative function in the VA process.

**What should be the grounds for initiating the VA of an MIS?**

Grounds for initiation of an MIS VA should be based on a modified ‘insolvency test’ supplemented by a
‘purpose test’ to account for the dynamics of MIS and the capacity for issues beyond insolvency to
affect viability and continuation.

We submit an appropriate insolvency based test could be based on the following:

- An MIS is or may be insolvent when scheme property is insufficient or may be insufficient to
  meet scheme liabilities to scheme creditors (irrespective of the solvency or otherwise of the
  RE).17

If the relevant person reasonably considers that the MIS is or may be insolvent then a VA procedure
can be initiated.

In addition, the following additional alternate ground is suggested:

- Where the relevant person reasonably considers that the purpose of the MIS cannot be
  achieved or may not be able to be achieved, a VA process can be initiated.

Viability may be a relevant consideration in the alternate ground as would the potential for third parties
to seek to enforce rights which may affect the MIS’s ability to continue.

**Who should be entitled to initiate the VA of an MIS?**

We submit that appointment of a VA should be made by the court on the application of specified classes
of persons or any other person sufficiently affected by the MIS.

We submit the following are appropriate persons to have immediate standing to apply to the court to
initiate the VA of a MIS:

- The directors or a liquidator or provisional liquidator of the RE or TRE;
- Substantial creditors;
- Members holding at least 5% of votes that could be cast at a meeting of the MIS.

In addition, the court should have discretion to recognise any person’s standing to apply for initiation of
an MIS VA provided they can demonstrate a sufficient connection and interest in the MIS or its
business.

---

17This formula is based upon discussion John Moutsopoulos and Jennifer Bell of Clayton Utz in their article *Insolvent
3* (October 2010) and accessible at
s.page
If the VA of an MIS is to involve classes other than MIS creditors:

- in relation to any voting on a proposed MIS deed:
  - how should the classes entitled to vote on the MIS 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

  We consider that the classes should be determined by the administrator based on the extent to which their interests are affected, however, because of the potentially complex nature of the rights which may be affected and the task of assessing the level of potential affect, we submit that the administrator should be required to obtain court approval.

  where classes vote on the deed, should they be entitled to vote on the whole deed or only that part that affects their interests

  We submit that classes should only be entitled to vote on the part of the MIS deed that affects their interests, however, in determining voting rights ‘affects’ should be given a broad and inclusive definition so as to encompass rights directly and indirectly affected.

  should the approval of all voting classes be required for the MIS deed to come into force, or should the deed apply to those classes that have approved it

  We do not consider that the MIS deed must be approved by all classes for aspects of the MIS deed to come into force.

  To the extent that the MIS deed can be compartmentalised such that different aspects of it can be effectively implemented without all others being implemented, then we support the implementation of a MIS deed to the classes that approve it.

  In simple cases, a partial implementation could effectively address the issues facing the MIS.

  In more complex cases, we think it is likely that a MIS deed will be of a more complex and interconnected nature, such that implementation of certain aspects will be ineffective unless all or some other aspects are also implemented.

  An MIS administrator may consider making aspects of a MIS deed explicitly interdependent, such that failure in approval of certain aspects precludes implementation of the MIS deed in any capacity.

  The ability to separately implement aspects of the MIS deed could be a matter to be considered by the court in the court approval process.

- what should be the voting rules for any proposal that:
  - the MIS be wound up, or
  - the MIS administration end and the MIS continue as before?

  We have not reached a concluded view on this question.

  Our preliminary submission is that a proposal to wind up the MIS should be passed by a majority of each class of participant, by value and number, or value of interests, as appropriate to the relevant class.

  A similar process could be adopted for approval of a proposal to end the administration and continue the MIS. However, given this is a less drastic step than winding up and only likely to be proposed in circumstances where there is sufficient confidence in the viability of the MIS and its ability to achieve its purpose, a lower or more flexible threshold may be appropriate.

  In what circumstances, if any, should an MIS deed be able to override the rights of members under the constitution of the MIS or impose new obligations on those members?

  An MIS deed should only be able to override the rights of members under the constitution of the MIS or impose new obligations on those members if members are entitled to vote on the aspects of the MIS deed which affect their rights, and the members approve the changes with a level of support equal to that which would be required under the Act to effect such changes by voting on resolutions at a members’ meeting.
5.5 Other matters relevant to the VA of an MIS

5.5.1 Avoiding duplicate VAs

Question
What, if any, legislative provision needs to be made to prevent duplicate VAs?

We support the suggested legislative restrictions detailed in section 5.5.1 of the Discussion Paper. Because of the potential greater complexity of an MIS VA, it is critical that all scheme property and claims by creditors be dealt with under the MIS VA. In addition, an administrator of the RE of the MIS should be required to give all reasonable assistance to the administrator of the MIS and legislative provision made to facilitate information sharing.

5.5.2 Who can be an MIS administrator

Question
In the context of an MIS administration, should there be any change to the current requirements that only a registered liquidator can be an administrator and, if so, why?

We support appointment as an MIS administrator being limited to registered liquidators with the following additional requirement.

In recognition of the specific and specialised activities certain MIS engage in, we consider that as part of the court appointment approval process, the court must be satisfied that the proposed MIS administrator has skills and experience commensurate with the size and complexity of, and relevant to, the business of the MIS. This would provide a sufficient check on the appointment of suitably skilled liquidators to complex and specialised MIS, or the appointment of liquidators who have outlined a framework to address any potential skill deficiencies or to ensure adequate experience and skills though the engagement of specialists to operate the company (compliance with such frameworks being a condition of appointment).

5.5.3 Powers and liabilities of the MIS administrator

Questions
Should an MIS administrator have similar powers to those of the administrator of a company?

We support MIS administrators having similar powers to the administrator of a company.

For what liabilities, if any, should an MIS administrator be personally liable, and what, if any, rights of indemnity should the administrator have against scheme property?

We submit that an MIS administrator should only be liable for contractual or other liabilities the administrator incurs while acting in the role of MIS administrator.

We support an MIS administrator having a right to indemnity out of scheme property for debts they lawfully incur while acting as MIS administrator of the MIS.

5.5.4 Remuneration of the MIS administrator

Questions
Who should determine the remuneration of an MIS administrator or an MIS deed administrator?

Through the court appointment approval process the court should approve the MIS or MIS deed administrators’ remuneration.

Support, or otherwise, of that remuneration by the committee of creditors and/or committee of members would be a relevant matter for the court.

What, if any, classes of persons in addition to the MIS creditors should be involved and in what manner and for what reasons?

We wish to comment on the term ‘MIS creditors’ in the Discussion Paper. It appears to refer to creditors of the RE in respect of which the RE has a right of indemnity from the scheme property, but
whom, following implementation of Reform 4, would have direct claims against the MIS property, thus becoming ‘MIS creditors’.

We reiterate that we do not support Reform 4.

If it is not implemented, then the process of MIS administration or liquidation will be complicated by the fact that such ‘MIS creditors’ will be claimants in the administration or liquidation of the RE, and strictly speaking not the MIS. However, it is desirable to have their derivative rights recognised.

We consider that provision should be made for creditors of the RE who have an expectation of an indemnity claim being made by the RE in respect of their debt to lodge proofs directly with the MIS administrator or liquidator in addition to the RE administrator or liquidator. The MIS administrator or liquidator would have to determine the recoverability of the RE from the MIS in respect of those claims, and could accept them directly for the value he considers the debt is indemnified.

Where we talk of creditors of the MIS or ‘MIS creditors’ we use the terms to mean persons who have lodged, or are entitled to lodge claims, and have them assessed, in this manner.

In response to the question we refer to our comments in relation to the preceding question. We consider the involvement of members (albeit indirectly given ultimate power to approve remuneration rests with the court reflects the significance of members in MIS).

**What priority provisions should there be for the remuneration of an MIS administrator or an MIS deed administrator, if the MIS goes into winding up?**

We support the same priority provisions for remuneration of MIS administrators or MIS deed administrators in any winding up of the MIS as are provided for corporate administrators.

### 5.5.5 Court powers

**Question**

**What powers should the court have in any VA of an MIS, and who should be entitled to apply to the court for this purpose?**

We support the court being given a broad discretionary power similar to that under section 447A of the Act to make such orders as it thinks appropriate about how the MIS VA procedures operate in relation to a particular MIS.

We consider that the following parties should be able to apply to the court for the purpose of the court exercising such a power:

- The RE;
- A member of the MIS;
- A creditor of the RE or MIS;
- The MIS administrator or deed administrator;
- ASIC; or
- Any other interested person.

### 5.5.6 Need for an ongoing RE

**In what circumstances, if any, should there be a power to appoint a TRE to operate an MIS in the context of a VA of that MIS, and who should be able to exercise any such power?**

If the MIS is viable or an MIS deed has been entered into, but the incumbent RE is unwilling or unable to continue in that role, the court should have the power to appoint a TRE to the MIS for the purpose of continuing the MIS to allow a potential replacement RE to be identified and due diligence to be conducted by it.

We submit the following should be able to apply to the court for this appointment:

- The RE;
- The MIS administrator or MIS deed administrator; or
4.6 Chapter 6 – Winding up a non viable MIS

4.6.1 Subsection 601GA(1) of the Act provides relevantly:

(1) The constitution of a registered scheme must make adequate provision for:

... winding up the scheme.

4.6.2 Problems in practice with winding-up MIS are largely the result of poor compliance with this requirement and inadequate provision for winding-up being provided in the constitution of the particular MIS. Further clarity in termination provisions of constitutions, in particular early termination, would have obviated the need for termination to be agitated in the courts so frequently in recent years.

4.6.3 Obviously, this is a failure of scheme operators in establishing the schemes. It is also a regulatory failure, with ASIC registering MIS whose constitutions do not comply with the requirements of subsection 601GA(1)(d) of the Act. The implications of this regulatory failure have become apparent since the onset of the global financial crisis.

4.6.4 It also raises the question of to what extent ASIC should actively oversee and regulate MIS. The registration regime, coupled with provisions in the Act such as subsection 601GA(1), appear designed to provide ASIC with a gatekeeper function that would prevent, where an operator or issuer failed to comply with the requirements of the Act, from that product being registered and issued because of ASIC’s final oversight and implicit approval role.

4.6.5 It may be argued that this is not the role ASIC should, or is able, to take. That may be the case, but this highlights the need to reconcile the Regulator’s expectations and intentions with those underpinning the MIS legislation.

4.6.6 We refer to the comments at page 89 regarding section 601NA and the explicit prohibition therein regarding attempts to entrench a particular RE through winding-up provisions.

4.6.7 We discuss ‘poison pills’ in MIS constitutions in more detail in section 5.3 below.

4.6.8 We also note the discussion at pages 95-6 of the Discussion Paper in relation to whether the MIS of an insolvent RE needs to be wound up. We note that a substantial amount of the discussion is predicated upon the implementation of Reform 4.

4.6.9 We reiterate our opposition to implementation of Reform 4.

4.6.10 We also refer to and note the various suggestions made by Garry Bigmore QC and Neil Hannan, in their article, Issues arising out of winding up managed investment schemes18, in particular their suggestion that the court be given power to:

a. appoint a receiver to a MIS to report to the court on the viability of the MIS and whether its assets should be sold; and/or

b. alter the provisions of Chapter 5C of the Act so as to allow the purpose of the MIS to be achieved taking into account the rights of the competing parties involved.

4.6.11 We see potential utility in their suggestion detailed in 1.2.11(b) where an MIS deed was unable to be approved by the various classes of parties to it.

4.6.12 Also, we refer to schedule 2 where we provide detail on the liquidation and administration of a number of REs of Agri MIS relevant to this discussion. In all of these cases, landlords (under the control of secured creditors) belonging to insolvent corporate groups, have been able to utilise the poisoning of the RE with the insolvency of the group (by means of cross guarantees in particular) to engineer a removal of the schemes from the land. This gives the landlord the ability to sell the land with clear title free from the encumbrances of the growers, who in many cases have invested significant sums of money in developing the assets being sold. A substantial number of investors borrowed to make their investments and have been saddled with the ongoing loan obligations notwithstanding the loss of their investments.

18 Insolvency Law Bulletin (October 2010) pp 42 to 45.
In addition, we make the following specific response to Chapter 6 of the Discussion Paper:

6.1.4 Application to practice

Questions

Are any changes needed to:

- the current circumstances where an MIS can be put into liquidation with/without the need for court approval?
- the provisions governing who can conduct the winding up?

There is presently a lack of clarity and express legislative provisions to provide a satisfactory range of 'tools' to wind-up an MIS in the varied circumstances in which it can be necessary.

In improving the winding-up framework, we think a distinction should be drawn between MIS which have accomplished their purpose and those where they cannot or appear unlikely to accomplish their purpose. MIS which were insolvent or may be insolvent and/or no longer viable would fall into the second category.

We consider the current framework for initiating and winding up schemes where the purpose of the MIS has been accomplished is sufficient (s.601NC) and should remain in the control of the RE in the first instance.

However, we consider reform is required in relation to MIS whose purpose cannot be accomplished.

In recognition of the fact that something may have gone 'awry' or 'amiss' in relation to such MIS, we submit that the winding-up should be conducted by a party independent to the RE, most appropriately a registered liquidator.

Such appointment should be made by the court on the application of either a creditor, member, ASIC or any other party sufficiently interested in the MIS.

We consider that the grounds for a court ordered winding up of an MIS should mirror those found in sections 459A, 459P, 461(1) and 464 of the Act.

We note, in particular, that this would confer explicitly on the court a general discretion to order that an MIS be wound-up where it was just and equitable to do so.

We also consider that the court should be conferred a power in respect of MIS to appoint a liquidator provisionally (see subsection 473(2) of the Act re corporations). A provisional liquidator of an MIS should be given the powers contained in subsections 473(3) to 473(6) of the Act.

In this context:

- should there be any changes to the procedures/thresholds for members of an MIS voting on any proposal by the RE to wind up that MIS and, if so, why

We submit that the onus should remain on members of MIS to call meetings if they do not agree with the RE’s proposal to wind up the scheme. We note that if the changes we outline above were adopted, RE winding ups would only occur where the purpose of the MIS had been accomplished, perhaps reducing the likelihood of members seeking to vote on the proposal.

Nonetheless, we recommend, consistent with our submissions elsewhere, that the threshold for passage of a resolution relating to the proposed winding up be reduced to a special resolution where 25% of those members eligible to vote have voted in favour of winding up the scheme.

- is there a need for a separate insolvency ground for winding up an MIS

As indicated above, we consider that an amendment should be made to Part 5C.9 to include similar provisions to those in Part 5.4 Division 3 and Part 5.4A of the Act, including a ground for winding up in insolvency.

- if so:
  - how should the insolvency of an MIS be defined
As detailed above, a potential definition is that an MIS is insolvent when scheme property is insufficient to meet scheme liabilities to creditors of the MIS, irrespective of the solvency or otherwise of the RE.\textsuperscript{19}

6.2 Liquidation of an MIS where the RE is solvent

Questions

Should there be any changes to the current provisions dealing with the winding up of an MIS by a solvent RE and, if so, why?

As set out above, we submit that where the purpose of the MIS has been achieved, it is appropriate for the RE to wind-up the MIS.

As we noted at paragraph Error! Reference source not found., problems in practice have arisen because MIS constitutions do not adequately provide a framework for winding-up the MIS.

We support implementation of a legislative framework and consider it could be based upon Part 5.5 Divs 2 and 4 bearing in mind that an RE will only be conducting the winding-up where the MIS’s purpose has been accomplished.

Where there is a question over the MIS’s insolvency or its ability to accomplish its purpose, we consider an independent party (such as a registered liquidator) should be appointed to wind-up the MIS.

We consider the liquidator should be given similar powers to those of Part 5.4 of the Act tailored to specifically apply to MIS.

6.4.7 Current power to initiate a separate liquidation

Questions

In what circumstances would it be suitable either to combine or to separate the liquidation of an RE and an MIS where there has been a separate VA of the MIS (if that power was introduced)?

In what circumstances would it be suitable either to combine or to separate the liquidation of an RE and an MIS where there has not been a separate VA of the MIS?

We note the observations in the Discussion Paper regarding the conflict that can arise or may be perceived to have arisen for a liquidator acting as liquidator of the RE and in effect, liquidating the MIS.

We consider that this conflict is best cured by separation of the role of liquidator of the RE and liquidator of the MIS.

At present, similar conflicts when faced by liquidators (including receivers and managers) of REs inevitably necessitate application to the court for judicial directions.

We acknowledge that separate liquidators may lead to litigation between these parties, but consider it may overall reduce the instance of litigation and otherwise benefit the winding up of the MIS.

With a separation between the interests of the RE and MIS in liquidation through separate liquidations, there may be greater capacity for competing claims to be compromised given the liquidators are freed of conflicts.

We consider because of the potential for conflicts to arise or be perceived, in most instances separate liquidations should be conducted.

We note that this may lead to increased expense and certain complexities as identified on page 100 of the Discussion Paper. However, in our experience, potential or actual conflicts have greatly increased the complexity of the liquidation of REs and required repeated applications to the court for directions.

In exceptional circumstances and where the prospect of conflict is low, the court may be able to order that one liquidator act in both capacities where it is in the interests of creditors and members and the liquidations are expected to be more straightforward.

If there are circumstances where a separation at the liquidation stage is suitable, are any legislative amendments needed to achieve this outcome? In this context:

- are any changes, or additions, needed to the current court power to appoint a person other than the RE (or its liquidator) to take responsibility for the liquidation of an MIS?

We refer to our previous submission that registered liquidators should be appointed to wind up MIS which are insolvent or where the purpose of the MIS cannot be accomplished.

6.5 Options for an MIS liquidation process

Question

Would the process for liquidating an MIS be better provided for by:

- an extension of the powers of the court in s 601EE to all MISs, or
- a legislative procedure containing some or all of the elements discussed in Section 6.6 and for what reasons?

We submit that the process for liquidating an MIS would be better provided for by a legislative procedure, accompanied by a right to apply to the court for directions and general court discretion to make any order it sees fit in relation to a liquidation on the application of certain parties.

We consider that the legislative framework should be derived largely from Chapter 5 Part 5.4 to Part 5.9 of the Act.

6.6.2 Procedural matters

Questions

What procedural provisions should there be for winding up an MIS and why?

We refer to our comments at paragraphs Error! Reference source not found. to Error! Reference source not found. in relation to the operation of the current legislative procedure to determine the winding up of an MIS.

We also refer to our comments above in response to the questions posed in the Discussion Paper in section 6.1.4 and 6.2.

We support the implementation of the procedural powers and obligations detailed in section 6.6.2 in particular:

- A liquidator of a MIS having the power to conduct compulsory examinations as approved by the court;
- A requirement of a liquidator to:
  - keep proper books;
  - meet certain requirements in relation to money received;
  - meet public notification requirements;
- a prohibition in similar terms to that contained in section 471A of the Act;
- court powers similar to those provided by section 483 and to make such orders as are just and to make appropriate orders concerning persons guilty of misconduct causing loss to an MIS.

In particular, should a party conducting a winding up:

- have information-gathering and other investigative powers comparable to those of the liquidator of a company

We strongly support such powers being given to a registered liquidator conducting the winding up of a MIS.
- have obligations to report to ASIC comparable to those of the liquidator of a company, including in relation to possible unlawful activity?

Again, we strongly support such obligations being imposed on the registered liquidator appointed to the MIS. It is of particular relevance as they will be appointed in circumstances of insolvency or where the purpose of the MIS cannot be accomplished such that there may be questions over the management of the MIS.

Would it be appropriate to give these powers to an RE conducting a winding up, given the central role of the RE in the activities of the MIS? Is this an argument for not permitting an RE to conduct the winding up of an MIS that it has been operating?

Given the RE will only be responsible for winding up MIS where the purpose has been accomplished, we do not consider that it is necessary for them to have such powers.

However, in the case of an MIS whose purpose cannot be accomplished or which is insolvent, there is an inherent conflict for the RE who has presided over the MIS’s failure if it were to act to wind up the MIS. For this reason, an independent and qualified party should be appointed to wind up such MIS and meet the obligations of investigation and reporting to ASIC.

6.6.3 Rights of priority creditors

Questions

Should there be a statutory order of priority in the winding up of an MIS? If so, what should it include, for instance, the remuneration and costs incurred by the liquidator of the MIS?

We consider that statutory priority should be given to fees of liquidators and administrators appointed to MIS.

In respect of trust-based MIS, we consider that the application of principles of trust law are adequate to deal with matters of priority and reform to the law is not required.

In respect of contract-based MIS, we note that the position is not so clear. Contract-based MIS have different structures with different relationships. Trust law provides little assistance. At the same time, over prescription through statutory order of priority may not assist given the potential for certain structures or arrangements to fall outside the statutory regime.

It may be that the order of priority in complex situations is a matter for consideration and determination by the court.

6.6.4 Voidable transactions

Question

Is there a need for voidable transaction provisions specifically applicable to the winding up of MISs and, if so, what should be the content of those provisions?

We have not considered the potential for voidable transaction provisions to be applied to a MIS winding up and as such, do not have any detailed submissions in relation to their content. However, we support provisions with a similar effect to those relating to corporations.

In particular, related party transactions should be subject to a strict regime of voidability, given the issues which have been observed in relation to Complex Group MIS and multi-function REs.

6.6.5 Access to books of the MIS

Question

What provisions, if any, should be included to deal with access to books of the MIS?

As we recommend that liquidators should be appointed for insolvent MIS, the same requirements of a corporate liquidator to keep books and provide access should be imposed (section 531 of the Act and regulation 5.6.02 of the Regulations).

This should be extended to explicitly provide for access by members.
6.6.6 Court power to give directions

Questions

Should there be any changes to the current provisions by which the court can give directions, 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 MIS liquidation provisions are to operate in relation to a particular MIS? If so, who should be entitled to apply?

We strongly support such a power being provided to the court.

The breadth and variety of structures, arrangements and relationships comprising and connected with MIS creates the need for dynamic response to novel or unexpected situations and consequences.

The court is best placed to respond to such circumstances through such a power.

We have seen many instances of receivers and managers, and liquidators, using court directions to obtain court sanction of actions in the context of the liquidation of REs and MIS.

An express power to direct how a MIS liquidation be conducted would simplify and promote orders as required.

We consider the following should be entitled to apply for such orders:

- The liquidator of the MIS;
- The RE or its liquidator or the TRE;
- A creditor of the MIS;
- A member of the MIS;
- ASIC;
- Any other interested person (which would include a potential new RE).

6.6.7 Position of MIS members

Questions

What provision, if any, should be made for MIS members in the winding up of their scheme?

As discussed in relation to potential MIS VA procedures, we consider that a committee of members should be appointed in a MIS liquidation to oversee the conduct of the liquidator and represent members’ interests.

Should the liquidator of an MIS have any statutory duty to members of that scheme and, if so, what and why?

Recent judgements in the Federal Court analysed the duties of liquidators and receivers in relation to members of MIS. The courts have considered the legislative intent in relation to whether a receiver is considered an ‘officer’ for the purpose of the duties of officers of an RE in subsection 601FD(1) of the Act, and how a liquidator’s duty to creditors is affected by subsection 601FD(1) of the Act. From our conversations with ASIC, these judgments are inconsistent with ASIC’s interpretation of the law and are also inconsistent with statements on their websites about the obligations of receivers.

There is considerable uncertainty arising out of the application of these cases. The duties of a liquidator in each of its potential roles (e.g. receiver, receiver & manager, administrator, liquidator etc.) should be clearly provided for in statute. If the duties of liquidators to members of MIS are restricted in the ways

---

21 Ibid at [42].
suggested by the courts, it is important that there is a clearer and more accessible mechanism for members to change the RE or have a TRE appointed.

6.7 Unregistered MISs

6.7.2 Unlawful unregistered MISs that are viable

Question

Should there be specific legislative provisions aimed at facilitating the registration of viable unregistered schemes so that they comply with the Corporations Act?

In our opinion, an express provision for the appointment of a TRE to such MIS for the purpose of determining their viability and/or preparing them for registration and either return to a suitably licensed RE or into control of a new RE would be desirable to facilitate continuation of illegal schemes which but for their regulatory non-compliance, are viable.

Alternatively, an express provision for the appointment of an administrator or receiver to the illegal MIS may achieve the same result.

6.7.3 Unlawful unregistered MISs that are not viable

Questions

Should a former member of an MIS have standing to apply for the winding up of an unregistered MIS?

We support such standing being given to former members.

Should a creditor have standing to apply for the winding up of an unregistered MIS?

We support such standing being given to creditors. This would be subject to any moratorium arising through the appointment of a TRE, administrator or receiver.

4.7 Chapter 7 – Other matters

4.7.1 We make the following response to chapter 7 of the Discussion Paper:

7.1 Convening scheme meetings

Questions

Should there be any changes to the grounds on which the RE, the members or the court can call meetings of members and, if so, for what reasons?

We consider, consistent with the recommendations of the Turnbull Report, which provision should be made in the Act for members to request the RE of a MIS to call a general meeting.

As identified in the Discussion Paper, such general meetings would provide an opportunity for members to ‘provide a sense of cohesive ownership and provide an opportunity for members to raise matters with the RE without the need to propose a special or extraordinary resolution.’

In recognition of the varied size and nature of MIS, we do not consider that all MIS should be required to hold an annual general meeting, but members should be able to request such a meeting. The threshold for the request should be as stipulated in subsection 249D(1) of the Act. Provided the threshold is met the RE should be obliged to hold the meeting.

Should there be provision for an annual general meeting of scheme members and, if so, should the purposes of such meetings be stipulated?

We refer to our comments above.

The requisitioning members should be required to state the purpose for which the meeting is called.

7.2 Cross guarantees

Question
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?

We submit that cross-guarantees and indemnities by REs of MIS should be expressly prohibited because of the substantial risks they create for MIS with multifunction REs and Complex Group MIS. The impact of these risks has been observed in the recent high profile Agri MIS collapses.

We support the proposed amendments of the licensing requirements by ASIC.

Because of the seriousness of this issue, irrespective of whether ASIC amends the licensing requirements, we consider prohibitions in the same form should be included in Chapter 5C of the Act.

We note that this would leave little doubt as to the legality of such arrangements and would enliven recovery provisions relating to breaches of Chapter 5C for members where contraventions may have occurred. More fundamentally, because of the seriousness of the issue the prohibition should be contained in the part of the Act expressly dealing with MIS.

7.3 Limited liability of MIS members

Questions

Except for schemes where the RE is the agent of the scheme members, should statutory limited liability of scheme members be introduced for all or some MISs? If so, should distinctions be drawn between different classes of passive or active MIS members, and for what purposes?

We submit statutory limited liability should be introduced for all MIS (where the RE is not acting as agent for the members).

We don’t think that distinguishing between levels of passivity or activism is useful or necessary. Fundamentally, where the RE is not acting as agent, the member has no active involvement in the MIS and no ready ability to influence its business or management, commensurate with passivism.

Should the limited liability principle be subject to any contrary provision in the scheme constitution?

We do not consider that the limited liability principle should be subject to contrary provisions in the MIS constitution. We have observed too many matters where constitutional provisions adverse to members’ rights have been inserted into constitutions with tacit member approval but in circumstances of inadequate disclosure or member engagement.

For this reason and because of the serious implications for members of the principle being modified or eroded, it should not be able to be modified by the MIS constitution.

7.4 Other matters

Question

Should any other legislative amendments be made to improve Chapter 5C of the Corporations Act and, if so, what and why?

We discuss a number of additional issues facing MIS, and potential policy or legislative responses to these issues, in section 5 ‘Other Matters’ below.

5 Other Matters

5.1 Additional issues facing MIS

5.1.1 As noted above, we have observed a number of additional issues facing MIS, in particular distressed MIS, which are either not addressed or not addressed in any detail, in the Discussion Paper.

5.1.2 The majority of these issues relate to the difficulties facing, and impediments to, members exercising their statutory rights to influence the management of the MIS. Whilst by definition a member has no ‘day-to-day’ control over the affairs of an MIS, the limited capacity they do have to effect change or influence management of MIS is an important right.
5.1.3 We have observed the majority of these issues in the context of our work in relation to trust based MIS, however, they are equally applicable to contract based MIS.

5.1.4 The major issues we have identified are:

   a. The difficulties members face in replacing an underperforming RE of an unlisted MIS including the high threshold for removal and replacement, practical issues relating to member engagement and entrenching provisions;

   b. Unresolved issues relating to the procedure of member meetings to consider resolutions for the removal and replacement of a responsible entity;

   c. Mismanagement and/or misconduct by the RE, in particular relating to:

      i. Conflicts of interest between the interests of schemes for a multi-function RE and between the REs interests and a particular MISs; and

      ii. Related party transactions; and

   d. Inadequacy of professional indemnity insurance cover.

5.2 Difficulties with replacement of an RE

5.2.1 It is an oft made observation that members of an unlisted MIS have limited rights by which they may influence its management or direction. When the practical difficulties associated with the exercise of those rights are considered, the actual extent of this limitation becomes clear.

5.2.2 The primary method by which members may influence the management of their investment is under the meeting procedures provided by Part 2G.4 of the Act, and the most powerful means is the removal and replacement of the RE. In our experience, effecting a change of RE of an unlisted MIS is extremely difficult.

5.2.3 Passage of an extraordinary resolution is an extremely high threshold. A high level of passivity and investor apathy has been observed in relation to such investments and significant resources and time is required to rally support for passage of the requisite resolution. Active members are in effect hamstringed by inactive members, and an underperforming or incompetent RE can get a ‘free pass’ because of this.

5.2.4 We have also observed that inevitably in the lead-up to a members’ meeting there will be a ‘battle’ between the incumbent RE and the proponents of its replacement for support. This will generally involve significant communications to investors and advisors by both parties to influence the completion of proxies.

5.2.5 We have also observed that an incumbent RE is in a particularly strong position to advocate against a proposal involving its replacement, often relying upon uncertainty or structural constraints, further complicating the process of change.

Inhibitive Funding Facilities

5.2.6 We refer to our comments in response to section 4.7 of the Discussion Paper in section 4.4 of our submission above regarding inhibitive funding facilities and similar agreements.

Collection of Proxies

5.2.7 In our experience there is a significant advantage to knowing the numbers of proxies collected and in whose favour they are made in the lead up to a meeting of members. It can inform the proponents on whether to press ahead with the meeting, and inform their communication strategy with members. It is similarly advantageous for the incumbent RE to be aware of the proxy count details.

5.2.8 A common practice we have implemented and observed involves the appointment of an intermediary to collect proxies and report to both parties on the collection on a regular basis. In some cases a registry services provider such as Computershare or Link has been appointed by the proponent of the replacement of the incumbent RE by an agreement that requires the proxy collector to act independently in completing their duties.

---

23 See for example: Lachlan REIT Limited v Garnaut & Ors [2010] VSC 399 (6 September 2010) at [38].
5.2.9 Despite the apparent conflict between the proxy collector acting independently and its appointment by the proponent, there are significant reputational and financial risks for an intermediary should they fail to act independently and breach their obligation to do so under the relevant agreement. Despite this a number of incumbent REs have opposed such a practice.

5.2.10 Section 252Z of the Act requires that proxies must be received by the RE 48 hours prior to the members’ meeting. However, the Act is silent on:
   a. Who may collect them; and
   b. By whom, and how, they must be delivered to the RE.

5.2.11 In a number of cases it has been argued that collection of the proxies by an intermediary prior to delivery to the RE in accordance with section 252Z presents the possibility of tampering with the proxies and is contrary to the Act.\(^{24}\) The legal position remains unclear.

5.2.12 We do not consider that such assertions are correct. In respect of any resolution for removal of an incumbent RE we note that it is an extraordinary resolution and there is no advantage to be gained by an intermediary who is engaged by or has a relationship with the proponents for replacement, failing to deliver unfavourable proxies. To the extent tampering involving alteration of proxies is suggested as a possibility, we note that the delivery of the proxies to RE provides the RE with an opportunity for inspection and identification of any proxies which are questionable.

5.2.13 In respect of special and ordinary resolutions there may be an advantage to be gained by withholding unfavourable proxies. In our opinion this risk can be suitably managed by the engagement of a disinterested intermediary and contractual requirements of transparency.

5.2.14 We also note that an RE fighting for its survival is in a position of significant conflict\(^{25}\). The delivery of proxies directly to the RE does nothing to reduce the possibility of tampering by the incumbent RE, and interposition of a relatively neutral and appropriately credentialed proxy collector improves the process.

5.2.15 We consider that legislative reform to approve the practice of proxy collection by an intermediary and to clarify the presently unclear status of the law in this area is appropriate.

5.2.16 If the alternative view is taken, and the law clarified to require proxies to be delivered directly to the RE, we consider it would be appropriate to insert a requirement that the RE provide regular updates to the proponents of the proposal as to the state of the proxies and a requirement that they make available for inspection the proxies in advance of and at the meeting.

Adjournment of meetings

5.2.17 There is presently a lack of clarity surrounding the operation of provisions governing adjournment of members’ meetings.

5.2.18 Section 252K of the Act requires a new notice of adjourned meeting if the meeting is adjourned by one month or more. We have been involved in disputes about the meaning of this clause in relation to the following:
   a. The details of the notice to be given;
   b. In the case of multiple adjournments, whether “one month or more” refers to the length of each adjournment or all adjournments;\(^ {26}\) and
   c. Whether it requires a new meeting (i.e. new proxies must be collected) or an adjournment of the unfinished business of the same meeting.

5.2.19 Section 252U only allows unfinished business to be transacted at an adjourned meeting. We submit that this should be brought into line with the common law which permits new business to be transacted if notice is given to members. We consider this better accommodates the fluid nature of the environment involved in restructuring MIS.

\(^{24}\) See: Bisan Ltd v Cellante (2002) 173 FLR 310; City Pacific Ltd v Bacon (2009) 72 ACSR 418; Lachlan REIT Ltd v Garnaut & Ors [2010] VSC 399 at [27].

\(^{25}\) See: Lachlan REIT Ltd v Garnaut & Ors [2010] VSC 399 at [27].

\(^{26}\) Re Colonial First State Trust Group [2002] ATP 16 (23 September 2002) is the only authority on the matter. It implies the latter which we consider is unworkable and plainly wrong as it would impose a mandatory notice period of 21 days on each adjournment after a month since the meeting was originally called.
The law requires clarification in this respect. Such clarification and/or reform should acknowledge the difficulties members have in reaching the thresholds for replacement of a RE, and the significant period of time that can be required to organise and mobilise members, develop a replacement proposal, call the meeting and rally provision of proxies and member engagement. These issues are discussed further in the context of contract based schemes below.

**Obligations of the RE with respect to meetings to consider their removal and replacement**

5.2.21 Recent matters have raised concerns over the conduct of REs in relation to meetings to consider their removal and replacement.

5.2.22 As noted above, an incumbent RE in such a position is in an irreconcilable position of conflict. There is significant potential for the meeting process to be derailed through unhelpful or resistant behaviour by a RE, which undermines the integrity of the process as an exercise of members' rights.

5.2.23 By way of example, we refer to the decision of the Honourable Justice Dowsett of the Federal Court in Wellington Capital Limited, in the matter of Premium Income Fund v Premium Income Fund Action Group [2011] FCA 781 (Wellington Capital Limited).

5.2.24 The facts of this case are illustrative of the background against which members’ meetings for removal of the RE are often conducted.

5.2.25 Often significant disputes arise over procedural and substantive issues related to the meeting, resulting in court proceedings. It is illustrative of the complicating effect that such disputes have on the meeting process and the capacity for them to derail the exercise of the members’ rights under that process. Whilst obviously genuine procedural and substantive issues relating to the meeting must be resolved and will at times necessitate resort to the courts, in our view, an RE is obliged through the obligations under subsection 601FC of the Act (as are its directors under section 601FD of the Act) to facilitate resolution of such disputes in the most efficient manner to allow members to exercise their rights. In practice, this does not always occur. Legislative reform to make explicit an incumbent RE’s responsibility to take all reasonable steps to facilitate the holding of a members’ meeting, and take no action to frustrate or impede the meeting may be required.

5.2.26 By way of example, alleged uncertainty over the status of Opus Capital Limited’s Australian Financial Services Licence was identified by Centuria as a significant issue for members in the Opus Capital and Income Fund No 21, and a reason why members should replace Opus with Centuria. Prior to the meeting being called Opus’ AFSL had been cancelled by ASIC, the cancellation set aside by the Administrative Appeals Tribunal (AAT) on review initiated by Opus, and ASIC appealed the decision of the AAT to the Federal Court.

5.2.27 In the period prior to the meeting, Opus contended that this alleged uncertainty was not a significant issue and propounded its confidence that the ASIC’s appeal to the Federal Court would be unsuccessful. Opus communicated with members stating it had legal advice to the effect that ASIC’s appeal would fail and the AAT’s decision was sound. Attached to this was a copy of a letter from a lawyer of the firm acting for Opus, which Opus attached in support of the representation made.

5.2.28 Centuria’s bid subsequently failed to attract the requisite member approval and Opus remained (and remains) RE.

5.2.29 On 31 August 2011 ASIC’s Federal Court appeal was successful, an outcome contrary to that advocated in the member communication discussed above.

5.2.30 This illustrates the conflict the incumbent RE finds itself in. Statements as to the confidence of the incumbent RE as to the likelihood of a particular state of affairs arising relevant to the matters to be considered by or as an adjunct to the members’ meeting should be tempered by acknowledgement of the uncertainty of outcomes and the possible range of outcomes available. This is not always the case.

5.2.31 By way of further example we refer to paragraphs 15 to 21 of Dowsett J’s judgment in Wellington Capital Limited. We note at the outset that the issues raised therein were not resolved in the proceedings before Dowsett J and remain disputed. However, they are illustrative of the issues that could arise if an RE, or its officers, take steps which may frustrate or impede the meeting process.

5.2.32 In particular, as the physical recipient of proxies prior to the meeting, the incumbent RE is in position whereby it can act to impede the process by failing to attend the meeting and prevent quorum requirements from being met.
5.2.33 A general requirement upon the RE as outlined at paragraph 5.2.24 above should also be accompanied by explicit statutory requirements that the incumbent RE attend any members’ meeting and produce all proxies in its possession at the meeting to prevent issues such as those alluded to in Wellington Capital Limited from arising and potentially impeding the exercise of members’ rights.

5.3 Entrenching provisions

5.3.1 We have observed a number of MIS constitutions containing provisions which entrench (act to significantly impede or constitute a significant disincentive in commercial and practical terms to the exercise by members of their statutory right to replace the incumbent RE) through:

a. Fees payable to the outgoing RE on its removal; or
b. Restrictive quorum and/or chair election requirements for meetings to consider resolutions for the removal and replacement of the incumbent RE.

Removal Fees

5.3.2 There is a lack of clear statutory or judicial authority on the propriety and legality of fees which seek to entrench an RE of a listed or unlisted MIS.

5.3.3 As noted in the Discussion Paper, RE fees are governed by subsection 601GA(2) which provides:

(2) If the responsible entity is to have any rights to be paid fees out of scheme property, or to be indemnified out of scheme property for liabilities or expenses incurred in relation to the performance of its duties, those rights:

(a) must be specified in the scheme’s constitution; and
(b) must be available only in relation to the proper performance of those duties; and any other agreement or arrangement has no effect to the extent that it purports to confer such a right.

5.3.4 Arguably, a fee whose basis is removal of the RE, is not in relation to a properly performed duty of the RE and therefore not permitted to be paid out of scheme property. However, we note the unusual drafting of subsection 601GA(2) and the use of the word ‘those’ in subsection 601GA(2)(b). However, there is presently some uncertainty in this area.

5.3.5 Ostensibly the requirements of subsections 601FC(1) and 601FD(1) of the Act (in particular subsections 601FC(1)(c) and 601FD(1)(c & (e)), should prevent the insertion of entrenching provisions in a MIS constitution or acts by the RE to facilitate such insertion. In turn, they should also prevent a RE from taking or paying such a fee.

5.3.6 Such a view is supported by the detailed decision of the Takeovers Panel in Re AMP Shopping Centre Trust (No 1)28 where the panel stated at [66]:

The Panel considers that there is a principle of “non-entrenchment” in the managed investment scheme provision of the Act and in the purposes of Ch 6 of the Act and that it should apply that principle in its consideration of this application. Its view is that the Act stands for a non-entrenchment principle is supported by the obligations imposed on a responsible entity to prefer the interests of interest holders in the managed investment scheme if the interests of those holders conflict with the responsible entity’s interests. Entrenchment would appear to run directly counter to this obligation (unless it had been given informed consent from the unitholders).

5.3.7 However, a review of secondary materials relating to the enactment of Chapter 5C of the Act does not reveal support for such a principle and there is no judicial authority on this point of which we are aware.

5.3.8 In contrast, the recent Federal Court decisions of Australian Olive Holdings Pty Ltd v Huntley Management Ltd (2010) 185 FCR 97 (AOL v Huntley) and Saker, in the matter of Great Southern

27 A similar definition of entrench was used by the Takeovers Panel in Re AMP Shopping Centre Trust (No 1) (2003) 45 ACSR 496.
28 (2003) 45 ACSR 496 at 508. The panel’s decision in Re AMP Shopping Centre Trust (No 1) was upheld on review in Re AMP Shopping Centre Trust (No 2).
Managers Australia Ltd (receivers and managers appointed) (in liquidation) [2010] FCA 1080 (Re Saker) appear to validate payments to an RE which have a disincentive effect on its replacement. We note that subsection 601GA(2)(b) was not argued in AOL v Huntley and was not considered relevant by the Court in Re Saker because of provisions in the scheme documents which had the effect that contributions made by growers lost the character of scheme property once paid into a Trust Maintenance Fund.

5.3.9 If not a case for law reform, this may instead be a regulatory failure. The constitutions of the MIS operated by the ‘Great Southern Group’ generally contained provisions whereby contributions from growers were paid to the RE as ‘fees’ and at that point lost their character as ‘scheme property’. This enabled the Great Southern Group to operate in a manner that has been likened to as a ‘ponzi’ scheme, with funds from one scheme being used to pay for expenses in others. It is submitted that such constitutions do not comply with s601GA(2)(b) and so the MIS should not have been registered with constitutions in that form.

5.3.10 We are not aware of any guidance from ASIC on the legality or otherwise of ‘poison pills’ in scheme constitutions but note their comments in the Turnbull Review.

5.3.11 We have observed MIS constitutions which provide for fees in the same form as or similar to the following:

> In the event that [the RE] is appointed … removed without its consent for any reason other than negligence or fraud, [the RE] will be entitled to receive payment of removal fee of 2% of the gross value of the Scheme (as determined in the most recent audited accounts) which fee is payable immediately prior to replacement of [the RE] as Responsible Entity of the Scheme. The fee will only be payable on removal of [the RE] as Responsible Entity of the Scheme and may not otherwise be claimed by [the RE] in any other circumstances.

5.3.12 Arguably such a fee is contrary to subsection 601GA(2) and other provisions of the Act, however, the position is presently unclear.

5.3.13 We consider that entrenchment is contrary to the principles underpinning Chapter 5C of the Act and the exercise of rights by members to control the management of MIS. We recommend that the ‘principle of non-entrenchment’ discussed by the Takeovers Panel in Re AMP Shopping Centre Trust (No 1) should be codified with an express prohibition on fees which have or may have the effect of significantly impeding, or constitute a significant disincentive to, the exercise of members’ statutory rights to remove and replace an RE of a MIS.

**Quorum requirements**

5.3.14 In addition to RE fees which may operate as ‘poison pills’ we have also observed provisions in MIS constitutions relating to quorum requirement for meetings to consider the removal and replacement of an RE, which act to impede the exercise of members’ statutory rights in that respect.

5.3.15 The following is such an example of a combination of provisions which have such a potential effect:

> 10.2 Except as provided for at subclause 10.3 below, two Unit Holders present constitute a quorum for a general meeting. No business may be transacted at any meeting except the election of a chairman and the adjournment of the meeting unless the requisite quorum is present at the commencement of the business.

> 10.3 The quorum for a meeting at which any resolution is proposed (whether ordinary or Extraordinary) to remove the Responsible Entity of the Scheme, is a minimum of four persons holding or representing in person, by proxy or attorney at least 51% of Units on issue in the Scheme by number.

> 10.4 The quorum for a meeting at which any resolution is proposed (regardless of the type of resolution) to amend clause 10.2 or clause 10.3 is at least four persons holding or representing in person, by proxy or attorney at least 51% of the Units by number.

5.3.16 Such provisions seek to elevate the barrier to such a meeting being convened. Whilst it will be necessary that over 50% of members vote in favour of resolutions for the removal and replacement of
an RE, this is a requirement only of the passage of the resolution, not the convening of the meeting. Such restrictions on quorum requirements would prevent a meeting being convened in circumstances where less than 51% of members are represented. The reality of meeting processes in this context is that meetings will often be convened and adjourned to a later date when the substantive resolutions are considered. Restrictive quorum requirements prevent the convening of the meeting and the commencement of the meeting process in the absence of the prescribed high threshold.

5.3.17 We also note the observations made at paragraphs 5.2.21 and 5.2.33 above regarding non-facilitative conduct by an incumbent RE who is in possession of proxies.

5.3.18 The above example of a restrictive quorum requirement is taken from the constitution of the Premium Income Fund ARSN 090 687 577, the MIS subject of the discussion at paragraphs 5.2.31 and 5.2.33 above and the proceedings in Wellington Capital Limited.

5.3.19 This illustrates the effect restrictive quorum requirements can have in circumstances where inhibitive or non-facilitative conduct by the incumbent RE is present.

5.3.20 In our opinion, there is no reason why the constitution of a MIS should depart from the ordinary quorum requirements provided for by the Act and the law should be reformed to prohibit departures from the law to the extent that they raise the threshold for quorum requirements.

**Election of chair**

5.3.21 Subsection 252S(3) of the Act provides that the members present must elect a member to chair the meeting.

5.3.22 In limited cases, we have observed MIS constitutions which place restrictions on the operation of subsection 253J(2) of the Act, whereby a poll cannot be demanded on any resolution for the election of the chair.

5.3.23 In our experience, and as is generally accepted, the chair of a meeting holds a significant and powerful position. They have effective control of the conduct of the meeting and certain critical functions such as those under section 253G of the Act. In addition, the chair has the discretion to adjourn a meeting.

5.3.24 We have observed constitutional provision in the following or similar form:

**28.4 Chairing meetings of Unitholders (section 252S)**

...  
(c) The Unitholders present at a meeting called under sections 252C, 252D or 252E of the Law must elect a Unitholder present to chair the meeting.

**30.8 Matters on which a poll may be demanded (section 253K)**

...  
(b) A poll cannot be demanded on any resolution concerning:

(i) the election of the chairperson of a meeting; or
(ii) the adjournment of a meeting.

5.3.25 The effect of such a provision is to complicate the process of the election of the chair, such as to require a critical mass of members to attend in person. The reality is that the majority of members may have granted proxies to a particular person and given them discretion to vote on such matters. However, provisions of this nature operate to frustrate the will of the members underlying the proxyholder (who may be a single individual and therefore can only cast one vote on a show of hands despite representing hundreds if not thousands of members).

5.3.26 We can see no justification for departure from subsection 253J(3) of the Act and consider that the legislation should be reformed to eliminate the prohibition of a poll being demanded and conducted on the election of the chair.
5.4 Section 173 – access to register of members

5.4.1 Pursuant to section 173 of the Act any person can inspect and obtain copies of a register kept under chapter 2C of the Act, including the register of members of a MIS.

5.4.2 Access to the register of members is critical to pursuing the replacement of an RE of a MIS, as it allows for communication with all members in relation to the proposal by its proponents, and provision of the notice of meeting, explanatory memorandum and proxy forms to the members.

5.4.3 In practice, our clients have experienced difficulties in exercising their rights under this section. REs have delayed or resisted providing the register of members, which has had the effect of delaying or complicating proposals for their replacement.

5.4.4 In addition, there have been disputes as to what information the RE must provide.

5.4.5 The register of members must include the details specified in subsections 169(6A) and (7) of the Act. In practice, MIS member registers often contain additional data including the email addresses of the members, and often the name and email addresses of their financial advisors.

5.4.6 In our view, section 173 of the Act requires that the register of MIS members be provided in the form in which it is kept. If the register ‘as kept’ includes additional information to that specified in subsections 169(6A) and (7) of the Act, then it should be provided ‘as is’ including that additional information.

5.4.7 In practice we have seen REs resist providing the register in the form in which it is kept by excluding certain information not required by subsections 169(6A) and (7), in particular email addresses and advisor details. Both these types of information are extremely useful in communicating with members in relation to a replacement RE proposal.

5.4.8 We consider that changes to the law are required to facilitate the effective operation of section 173 and to promote members’ ability to exercise their statutory rights.

5.4.9 We submit that section 173 of the Act be clarified to provide that the register should be provided in the form in which it is kept and the copy provided contain all information on the register.

5.4.10 We further submit that subsections 169(6A) and (7) be modified to include a requirement that the register record the members’ email address and the name and email address of their financial advisor, if these details are known to the RE.

5.4.11 Finally, we submit that consideration should be given to requiring the RE to lodge copies of the register of members with ASIC at certain specified periods[29], so that members and other persons can obtain the register directly from ASIC and avoid difficulties which may arise in utilising section 173 of the Act. This would also allow ASIC to collect significant data in relation to the membership of MIS and changes in that membership.

5.5 Compensation arrangements

5.5.1 In our experience the regulatory regime intended to ensure there is adequate insurance cover to compensate retail investors in MIS is failing drastically.

5.5.2 In a number of matters in which we have been involved, in particular in relation to trust-based MIS, the inadequacy of professional indemnity insurance cover has effectively precluded action being taken by or on behalf of retail investors in those MIS to recover compensation for substantial losses suffered as a result of potential contraventions of chapter 7 and 5C of the Act, and general law.

5.5.3 We consider that a more prescriptive regime is required, and that ASIC should take a more active role in enforcing it.

5.5.4 This may require ASIC taking a more flexible approach to what is required to be covered under the relevant insurance cover to ensure that sufficient quantum of cover for the majority of losses that may be suffered can be obtained on reasonable commercial terms.

5.5.5 If Reform 4 proposed in chapter 3 of the Discussion Paper is to be considered, let alone implemented, then remedying the current failures of the compensation arrangements regime is critical. Implementation of Reform 4 would see the burden of pursuing an RE who acted beyond power shifted

[29] Lodgement at intervals between monthly and quarterly would be appropriate – the more frequent, the more current the information.
from creditors to members. In circumstances where the insurance cover of the RE is inadequate this would simply reallocate that loss to members without any effective mechanism for recovery.

The regulatory regime

5.5.6 Section 912B of the Act provides that:

1) If a financial services licensee provides a financial service to persons as retail clients, the licensee must have arrangements for compensating those persons for loss or damage suffered because of breaches of the relevant obligations under this Chapter by the licensee or its representatives. The arrangements must meet the requirements of subsection (2).

2) The arrangements must:
   (a) if the regulations specify requirements that are applicable to all arrangements, or to arrangements of that kind—satisfy those requirements; or
   (b) be approved in writing by ASIC.

5.5.7 Regulation 7.6.02AAA of the Regulations provides that:

1) For paragraph 912B (2) (a) of the Act, arrangements mentioned in subsection 912B (1) of the Act are, unless the financial services licensee is an exempt licensee, subject to the requirement that the licensee hold professional indemnity insurance cover that is adequate, having regard to:
   (a) the licensee’s membership of a scheme (or schemes) mentioned in paragraph 912A (2) (b) of the Act, taking account of the maximum liability that has, realistically, some potential to arise in connection with:
      (i) any particular claim against the licensee; and
      (ii) all claims in respect of which the licensee could be found to have liability; and
   (b) relevant considerations in relation to the financial services business carried on by the licensee, including:
      (i) the volume of business; and
      (ii) the number and kind of clients; and
      (iii) the kind, or kinds, of business; and
      (iv) the number of representatives of the licensee.

5.5.8 Essentially, as a financial service provider and holder of an AFSL, an RE must hold professional indemnity insurance cover that is ‘adequate’ with regard to nature, scale and complexity of their business, and their other financial resources30.

5.5.9 As stipulated in ASIC regulatory Guide 12631 (RG 126):

…it is up to each licensee to determine what is adequate PI insurance for them to meet their obligations under s912B and obtain such PI insurance.

ASIC will not ‘approve’ a licensee’s PI insurance arrangements.

5.5.10 ASIC RG 126 provides the following guidance on the minimum requirements:

<table>
<thead>
<tr>
<th>Amount of Cover</th>
<th>Minimum requirement</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>We consider that, to be adequate, a PI insurance policy must have a limit of at least $2 million for any one claim and in the aggregate for licensees with total revenue from financial services provided to retail clients of $2 million or less. For</td>
</tr>
</tbody>
</table>

30 See ASIC Regulatory Guide 126 (RG 126) at 126.61.
31 RG 126 at 126.61-2.
licensees with total revenue from financial services provided to retail clients greater than $2 million, minimum cover should be approximately equal to actual or expected revenue from financial services provided to retail clients (up to a maximum limit of $20 million).

5.5.11 The onus of compliance with section 912B rests with the RE, and the adequacy of their cover, as required by regulation 7.6.02AAA(1), is a matter of the RE’s subjective assessment. It is, essentially, a system of self-regulation.

Current problems and required response

5.5.12 In our experience, this ‘self-regulation’ is not working. We have observed REs with only the minimum of $2 million prescribed by RG 126, irrespective of the nature, scale or complexity of their business and the risks attached to it. In our opinion, in certain of these cases, that cover was grossly inadequate.

5.5.13 More problematic is the fact that this inadequacy is only being identified in circumstances where losses have been incurred and/or the RE has failed. By this time, it is too late.

5.5.14 In addition, the guidance in RG 126 regarding amount of cover is based on expected or actual revenue, not funds under management. In respect of MIS, where revenue is often a small proportion of the net assets or invested capital, this is of limited relevance where actions of the RE can place significant amounts of the net assets or invested capital at risk, and substantial losses suffered.

5.5.15 We submit that a more prescriptive approach coupled with a policy of proactive assessment by ASIC is warranted to address these issues and to identify inadequacy in advance of losses being incurred.

5.5.16 In addition, we note that commercial constraints can contribute to the cover obtained by REs. In this respect, it is important to consider whether ASIC’s policy of requiring professional indemnity cover for fraud may have a counterproductive effect. Inclusion of fraud cover significantly increases premium expense and could be resulting in REs obtaining lower quantum in order to afford fraud cover. We consider this issue requires further consideration in any reform of the compensation arrangements regime.
## Schedule 1 – Cases

<table>
<thead>
<tr>
<th>Proceeding</th>
<th>Brief Description</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Non-agricultural scheme related cases</strong></td>
<td></td>
</tr>
</tbody>
</table>
| NSW Supreme Court No. 1344 of 2009 | **ANZ CASH PLUS FUND – Frozen Funds**  
*ING Funds Management Ltd v ANZ Nominees Ltd; ING Funds Management Ltd v Professional Associations Superannuation Ltd* [2009] NSWSC 243  
Amendment to scheme constitution to freeze funds set aside as it was found that the amendment "adversely affect[s] the rights of members of the fund" in contravention of section 601GC of the Corporations Act 2001 (Cth) (Act). |
| **VIC Supreme Court SCI 2010 4565** | **BECTON – Removal of Responsible Entity**  
Members of managed investment schemes called a meeting to replace a financially distressed responsible entity (RE). The RE applied for an injunction to prevent the meetings. |
| **Timbercorp agricultural scheme related cases** | |
| VIC Supreme Court No. 7114 of 2009 | **TIMBERCORP ALMOND & OLIVE SCHEMES – Application to wind up**  
The Timbercorp Growers Group, representative of members’ interests in the various Timbercorp almond and olive managed investment schemes (Schemes) successfully opposed the application made by the Liquidators in the Victorian Supreme Court to wind up the Schemes. |
| VIC Supreme Court No. 9408 of 2009 | **TIMBERCORP ALMOND SCHEMES – Directions regarding sale of assets**  
The Supreme Court of Victoria allowed entry into the sale of almond assets on the basis that funds received from the sale would be placed into a separate account, and a separate proceeding then be commenced to decide the appropriate apportionment. |
| VIC Supreme Court SCI 2009 10699 | **TIMBERCORP ALMONDS APPORTIONMENT – Rights Proceeding**  
An application in the Supreme Court of Victoria made by the Liquidators of Timbercorp Securities Ltd (TSL) for directions regarding the apportionment of the net sale proceeds between the Growers and Secured Creditors of the sale of almond assets to Olam. Davies J found against the Growers. |
| VIC Appeals Court S APCI 2011 0103 | **TIMBERCORP ALMONDS APPORTIONMENT - Appeal**  
*IN PROGRESS - GRAHAM GOLDBERG & Ors v BOSI SECURITY SERVICES LIMITED & Ors*  
This is an appeal against the decision of Davies J in the case above. |
| VIC Supreme Court SCI 2009 10382 | **TIMBERCORP TIF ALMONDS APPORTIONMENT**  
An application in the Supreme Court of Victoria made by the Liquidators of TSL, the RE of the almond schemes, in relation to the apportionment of the proceeds of sale from the Timbercorp almond scheme assets. |
| VIC Supreme Court SCI 2010 1354 | **TIMBERCORP OLIVE SCHEMES – Olives Apporportion**  
*IN PROGRESS – Bosi Security Services Limited 9ACN 009 413 852* (as Trustee for Australia and New Zealand Banking Group Limited (ACN 005 357 522) and BOS International (Australia) Limited (ACN 066 601 250) and Westpac Banking Corporation (ACN 007 457 141) v BB Olives Pty Ltd (in liq) (ACN 083 992 367) and ors*  
An application in the Supreme Court of Victoria made by the Liquidators of TSL, the RE of the olive schemes, in relation to the apportionment of the proceeds of sale from the Timbercorp olive scheme assets. |
<table>
<thead>
<tr>
<th>Proceeding</th>
<th>Brief Description</th>
</tr>
</thead>
</table>
| **VIC Supreme Court SCI 2010 398** | **TIMBERCORP CITRUS SCHEMES** – Citrus Apportionment  
*IN PROGRESS - Re Timbercorp Securities Limited (in liq) [2010] VSC 50 (26 February 2010)*  
An application in the Supreme Court of Victoria made by the Liquidators of TSL for directions regarding the sale of the Solora citrus assets. |
| **VIC Supreme Court SCI 2011 888** | **TIMBERCORP CITRUS SALE** - Kangara Assets  
*IN PROGRESS - Re Timbercorp Securities Limited (in liq) [2011] VSC 83 (15 March 2011)*  
An application in the Supreme Court of Victoria made by the Liquidators for directions pursuant to section 511 of the Act regarding the sale of the non-Solora citrus assets. |
| **VIC Supreme Court SCI 2010 07029** | **TABLE GRAPES** - Table Grapes Sale  
*IN PROGRESS - Re Timbercorp Securities Limited (in liq) (No 4) [2011] VSC 24 (7 February 2011)*  
An application in the Supreme Court of Victoria brought by the Liquidators of TSL pursuant to section 511 of the Act regarding the sale of land and water rights relating to the Timbercorp table grape schemes. |
| **Federal Court (VIC) VID 497 of 2009** | **TIMBERCORP FORESTRY** – Injunction and disclaiming leases  
The Federal Court of Australia ruled that the leasing obligations of Timbercorp Limited, incurred prior to its collapse, were not expenses that the Liquidators had to pay in priority to other creditors' claims. The Liquidators, were therefore, not forced to disclaim or terminate the Timbercorp leases, which may have adversely affected Growers. |
| **Federal Court (VIC) VID 541 of 2009** | **TIMBERCORP FORESTRY** – Extension of time  
An application made to the Federal Court of Australia seeking further time in which to respond to notices served under subsection 568(8)(b) of the Act. |
| **Federal Court (VIC) VID 595 of 2009** | **TIMBERCORP FORESTRY** – Implementation of SPD  
*Commonwealth Bank of Australia v Fernandez [2010] FCA 1487*  
An application by TSL (In Liquidation) for the Liquidators of TSL to seek a power of sale to enable the implementation of the sale/recapitalisation strategy. |
| **VIC Supreme Court No. 8870 of 2009** | **TIMBERCORP** - Termination of Lease / Relief Against Forfeiture  
An application in the Supreme Court of Victoria by TSL (In Liquidation) for relief from forfeiture due to the purported termination of leases by Plantation Land Limited. The matter was settled out of court. |

**Great Southern agricultural scheme related cases**

| **VIC Supreme Court No. 8169 of 2009** | **GREAT SOUTHERN** – Lien  
*Re Great Southern Managers (Australia) Limited (No 1) [2009] VSC 642 (19 August 2009)*  
A proceeding concerning the indemnity granted in the earlier proceeding no. 6861 of 2009, which is supported by an equitable lien over the trees, olives, grapes or almonds and any resultant sale proceeds. The proceeding was to determine the scope of the lien supporting this indemnity. |
| **VIC Supreme Court SCI 2009 10266** | **GREAT SOUTHERN** – Notice of Meeting  
*Re Great Southern Managers Australia Limited (rec’s & m’gers app’td) (in liq) [2009] VSC 557 (4 December 2009)*  
A proceeding brought by the Receivers & Managers of the RE seeking directions it was justified in putting Gunns’ proposal for certain schemes to meetings of Growers. |
<table>
<thead>
<tr>
<th>Proceeding</th>
<th>Brief Description</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>VIC Supreme Court</strong>&lt;br&gt;SCI 2009 10745</td>
<td><strong>GREAT SOUTHERN</strong> – Approval of Implementation&lt;br&gt;&lt;em&gt;Re Great Southern Managers Australia Limited (recs &amp; mgrs app’t) (in liq) [2009] VSC 627 (31 December 2009)&lt;/em&gt; &lt;br&gt;A proceeding brought by the Receivers &amp; Managers of the RE to seek approval of the implementation of the resolutions passed by Growers at the meetings.</td>
</tr>
<tr>
<td><strong>VIC Supreme Court</strong>&lt;br&gt;SCI 2010 07069</td>
<td><strong>GREAT SOUTHERN</strong> – Termination of Leases / Relief Against Forfeiture&lt;br&gt;&lt;em&gt;Primary RE Limited v Great Southern Property Holdings Limited (recs &amp; mgrs apptd) (in liq) &amp; Ors [2011] VSC 242 (8 June 2011)&lt;/em&gt; &lt;br&gt;A proceeding brought by Primary RE Limited (Primary), the replacement RE of the Great Southern Plantations 2007 scheme, against various landowning entities in the Great Southern Group and their Receivers/Receivers and Managers. Primary sought declarations that the termination of leases between the former RE, Great Southern Managers Australia Limited, and the landowning entities, was invalid and the leases remained valid and enforceable, and in the alternative relief from forfeiture of those leases. This relief was claimed to allow the scheme to continue. Justice Judd held that the terminations were valid and that Primary had no standing to seek relief from forfeiture, as this right did not novate under section 601FS of the Act. Accordingly relief from forfeiture was not granted. Primary RE Ltd elected not to appeal.</td>
</tr>
<tr>
<td><strong>VIC Supreme Court</strong>&lt;br&gt;SCI 2011 00725</td>
<td><strong>GREAT SOUTHERN</strong> – Removal of Caveats&lt;br&gt;&lt;em&gt;Great Southern Property Holdings Limited v Primary RE Limited &amp; Anor. Heard with Primary RE Limited v Great Southern Property Holdings Limited (recs &amp; mgrs apptd) (in liq) &amp; Ors [2011] VSC 242 (8 June 2011)&lt;/em&gt; &lt;br&gt;An application by Great Southern Property Holdings Limited for the removal of caveats lodged by Primary RE Ltd to protect equitable leases it claimed by virtue of the invalid termination of the leases subject of proceeding SCI 2010 07069. This proceeding was heard with proceeding SCI 2010 07069 and judgment delivered in favour of the plaintiff.</td>
</tr>
<tr>
<td><strong>TAS Supreme Court</strong>&lt;br&gt;TAS SC 91 OF 2011</td>
<td><strong>GREAT SOUTHERN</strong> –&lt;br&gt;&lt;em&gt;Great Southern Property Holdings Limited v Primary RE Limited &amp; Anor&lt;/em&gt; &lt;br&gt;A further application by Great Southern Property Holdings Limited for the removal of caveats lodged by Primary RE Ltd to protect equitable leases it claimed by virtue of the invalid termination of the leases subject of proceeding SCI 2010 07069. This proceeding was discontinued with the parties' consent following judgment in proceeding SCI 2010 07069 and Primary RE Ltd’s withdrawal of the relevant caveats.</td>
</tr>
<tr>
<td><strong>WA Supreme Court</strong>&lt;br&gt;COR 35 of 2010</td>
<td><strong>GREAT SOUTHERN</strong> – Olives Apportionment&lt;br&gt;&lt;em&gt;Great Southern Managers Australia Ltd (IN LIQ) in its capacity as responsible entity of various managed investment schemes v Thackray [2010] WASC 138 (15 June 2010)&lt;/em&gt; &lt;br&gt;An application by Growers applied to the Supreme Court of Western Australia for apportionment of sale proceeds of scheme assets. The application was withdrawn by consent.</td>
</tr>
<tr>
<td><strong>VIC Supreme Court</strong>&lt;br&gt;SCI 2010 6155</td>
<td><strong>HVT SCHEMES</strong>&lt;br&gt;&lt;em&gt;In the matter of Lowell Capital Limited&lt;/em&gt; &lt;br&gt;The RE is seeking judicial approval of reconstructed plantation schemes previously run by Great Southern Limited.</td>
</tr>
<tr>
<td><strong>Rewards agricultural scheme related cases</strong></td>
<td><strong>REWARDS MANAGED INVESTMENT SCHEMES</strong>&lt;br&gt;&lt;em&gt;Rewards Land Pty Ltd (Administrators appointed) (Receivers and Managers appointed) v Martin Bruce Jones, Andrew John Sake and Darren Gordon Weaver in their capacity as joint and several administrators of Rewards Projects Ltd and others [2010] WASC 233 (2 September 2010)&lt;/em&gt; &lt;br&gt;A dispute over the right of Rewards Land Pty Ltd and ARK to possession of leased properties. The Administrators submitted that if the plaintiffs retake possession of the leased lands it will be practically impossible for the administrators of Rewards Projects to propound a deed of company arrangement that will enable the schemes to continue in some form. The plaintiffs submitted that the evidence in support of that contention was insufficient.</td>
</tr>
<tr>
<td>Proceeding</td>
<td>Brief Description</td>
</tr>
<tr>
<td>------------------------------------</td>
<td>---------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------</td>
</tr>
<tr>
<td><strong>FEA agricultural scheme related cases</strong></td>
<td></td>
</tr>
<tr>
<td>Federal Court (VIC) VID 283 2010</td>
<td><strong>FEA SCHEMES</strong> – Scheme Property</td>
</tr>
<tr>
<td></td>
<td><em>Silvia v FEA Carbon Pty Ltd (ACN 009 505 195) (Administrators Appointed) [2010] FCA 515 (30 April 2010)</em></td>
</tr>
<tr>
<td></td>
<td>Clarendon Lawyers acted for the FEA Growers Group in an application by the Administrators of FEA Plantations Limited (Administrators) in the Federal Court of Australia for orders regarding clarification of the scope of property included in the administration.</td>
</tr>
<tr>
<td>Federal Court (VIC) VID 349 2010</td>
<td><strong>FEA SCHEMES</strong> – Meetings</td>
</tr>
<tr>
<td></td>
<td><em>Silvia, in the matter of FEA Plantations Ltd (Administrators Appointed) [2010] FCA 468 (12 May 2010)</em></td>
</tr>
<tr>
<td></td>
<td>Clarendon Lawyers acted for the FEA Growers Group in an application by the Administrators in the Federal Court of Australia for orders extending the time to hold creditors meetings.</td>
</tr>
<tr>
<td>Federal Court (VIC) VID 555 2010</td>
<td><strong>FEA SCHEMES</strong> – External Leases</td>
</tr>
<tr>
<td></td>
<td><em>Norman, in the matter of Forest Enterprises Australia Limited (Administrators Appointed) (Receivers &amp; Managers Appointed) v FEA Plantations Ltd (Administrators Appointed) (Receivers Appointed) [2010] FCA 1274 (18 November 2010)</em></td>
</tr>
<tr>
<td></td>
<td>Clarendon Lawyers acted for the FEA Growers Group in resisting an application made by the Receivers of FEA Plantations Limited in the Federal Court of Australia to terminate external leases on plantation land. This application was dismissed.</td>
</tr>
<tr>
<td>Federal Court (VIC) VID 692 2010</td>
<td><strong>FEA SCHEMES</strong> – Internal Leases</td>
</tr>
<tr>
<td></td>
<td><em>Norman, in the matter of Forest Enterprises Australia Limited (Administrators Appointed) (Receivers &amp; Managers Appointed) v FEA Plantations Ltd (Administrators Appointed) (Receivers Appointed) (No 3) [2011] FCA 624 (3 June 2011)</em></td>
</tr>
<tr>
<td></td>
<td>Clarendon Lawyers acted for the FEA Growers Group in resisting an application made by the Receivers of FEA Plantations Ltd in the Federal Court of Australia for termination of internal leases on plantation land. The application was dismissed in part (the Receivers have appealed in VID 1179 2010).</td>
</tr>
<tr>
<td>Federal Court (VIC) VID 1179 of 2010</td>
<td><strong>FEA SCHEMES</strong> – Appeal</td>
</tr>
<tr>
<td></td>
<td><em>Norman; in the matter of Forest Enterprises Limited v FEA Plantations Limited [2011] FCAFC 99 (9 August 2011)</em></td>
</tr>
<tr>
<td></td>
<td>Clarendon Lawyers acted for the FEA Growers Group in opposing the appeal by the Receivers of FEA Plantations Ltd in the Full Court of the Federal Court of Australia against the judgement made in VID 692 2010. Judgment is anticipated to be made in late 2011.</td>
</tr>
<tr>
<td><strong>Willmott agricultural scheme related cases</strong></td>
<td></td>
</tr>
<tr>
<td>Federal Court (VIC) VID 836 of 2010</td>
<td><strong>WILLMOTT SCHEMES</strong> – Removal of Administrator</td>
</tr>
<tr>
<td></td>
<td><em>Commonwealth Bank of Australia v Fernandez [2010] FCA 1487</em></td>
</tr>
<tr>
<td></td>
<td>Application by secured creditor, Commonwealth Bank of Australia, for removal of administrator A T Fernandez and appointment of Messrs I Carson and C Crosbie in his place as administrator of Willmott Forests Limited. Clarendon Lawyers acted for the Willmott Growers Group Inc (WGG) and appeared in support of the CBA’s application. The court granted the application and removed Mr Fernandez appointing Messrs Carson and Crosbie in his place.</td>
</tr>
<tr>
<td>Federal Court (VIC) VID 386 of 2011</td>
<td><strong>WILLMOTT SCHEMES</strong> – Approval of Amendments to Constitutions</td>
</tr>
<tr>
<td></td>
<td><em>Re Willmott Forests Limited (receivers and managers appointed) (in liquidation)</em></td>
</tr>
<tr>
<td></td>
<td>Clarendon Lawyers acted for WGG, an intervener in the Liquidators’ application in the Federal Court of Australia seeking various directions pursuant to s 511 of the Corporations Act, including that they are justified in procuring the RE of the Willmott schemes to amend scheme constitutions and disclaiming the Project Documents as being onerous. The application was granted, subject to the requirement that the Liquidators must obtain Court approval prior to exercising their rights. It is anticipated that the Liquidators will make further application to the Court towards the completion of their sale process of land on which the Willmott schemes were conducted.</td>
</tr>
<tr>
<td>Proceeding</td>
<td>Brief Description</td>
</tr>
<tr>
<td>------------</td>
<td>------------------</td>
</tr>
</tbody>
</table>
| **Supreme Court (VIC) SCI 3155 of 2011** | **WILLMOTT SCHEMES – Injunction Against Voting on Constitutional Amendments**  
**IN PROGRESS - Willmott Forests Limited (receivers and managers appointed) (in liquidation) & Ors v Grimsey Financial Services Pty Ltd & Ors**  
Willmott Forests Limited (WFL) in its personal capacity and its receivers and managers brought proceedings seeking permanent injunctions restraining the defendants from putting to Growers resolutions for the removal of WFL as RE of the Willmott Forests 1995-1999 Project and implementation of a proposal for restructure and continuation of the scheme. The plaintiffs claimed certain proposed amendments to the project constitution to implement the proposal would affect a fraud on the minority of Growers who cannot or will not contribute to a reconstituted scheme. Clarendon Lawyers acted for the defendants (WGG and the attorneys of the requisitioning members or persons associated with them). The application was supported by the Liquidators of WFL.  
After an interlocutory hearing injunctions were granted on an interlocutory basis until further order with trial of the matter to commence 14 December 2011. |
Schedule 2 – Observations on failed agricultural MIS

Observations on external administration of failed agricultural MIS

1.1. Overview

1.1.1. Different methods have been adopted to manage the insolvency of agricultural MIS by insolvency practitioners acting for secured creditors of corporate groups which operate agricultural MIS.

1.2. Timbercorp Group

1.2.1. The directors of Timbercorp Limited appointed administrators to the Timbercorp Group of companies. Within that group there were various companies with different roles, ie, a finance company which made loans to investors, land owning companies which owned land upon which schemes were operated, a responsible entity (RE) holding an AFSL which acted as responsible entity for registered schemes and service entities which provided services to the schemes. There were also a few unregistered schemes of which the responsible entity was trustee/manager/responsible entity. The responsible entity was Timbercorp Securities Limited.

1.2.2. The creditors of the Timbercorp Group appointed the administrators as liquidators. Subsequently, the liquidators sought to wind up the schemes. Applications were made in the Federal Court of Australia for forestry schemes and in the Supreme Court of Victoria for almond and olive schemes.

1.2.3. A growers’ group known as Timbercorp Growers Group intervened and opposed the application to wind up the schemes.

1.2.4. Eventually, the Court made an order that the responsible entity have power to amend the constitutions of the schemes to cancel growers’ rights to enable the assets to be sold – land and improvements, in return for the right to make claims against the sale proceeds in apportionment cases.

1.2.5. In the case of forestry, the Federal Court of Australia made a similar order and the forestry assets were sold. The purchase price was apportioned in the contract of sale between land and trees, with the proceeds of the land going to the secured creditors and the proceeds of the sale of the trees going to scheme members.

1.2.6. In the case of some of the almond schemes, an apportionment case has been completed with the secured creditors being awarded an entitlement to all of the proceeds of scheme assets. That decision is currently being appealed against by the growers. There are still to be apportionment cases heard in relation to the balance of the almonds, the olive schemes and the citrus schemes.

1.2.7. The significant feature of the Timbercorp insolvency is that the liquidator of the Timbercorp land owning company and the liquidators of the responsible entity were the same person. The secured creditors never appointed receivers over any of the entities.

1.2.8. There were head leases between the Timbercorp land owning company and the responsible entity, which, in turn, granted either licences or subleases to scheme members.

1.2.9. No steps were taken by the landowning companies to terminate the head leases or by the responsible entity to terminate the licences or the subleases. The liquidator may have refrained from taking either of these steps conscious of his obligations under subsection 601FD(1)(c) of the Corporations Act 2001 (Act) to act in the best interests of scheme members and to prefer the interests of scheme members to those of any others.

1.2.10. The original intention of the Timbercorp Growers Group was to replace the RE for some or all of the schemes. The group approached ASIC and requested it to make an application to the Court for the appointment of a temporary RE. ASIC refused to undertake this course on the grounds that it might lead to the eventual winding up of the schemes.

1.2.11. A number of the schemes were viable and it would have been in the interests of the members in those schemes for the schemes to continue. Regardless of whether the schemes were viable, members who made substantial investments in the schemes, many of whom continue to have borrowings to fund
those investments, have lost their investments through no fault of their own in order to maximise the recovery by the secured creditors of the land owning companies.

1.3. Great Southern

1.3.1. The Great Southern insolvency took a different route to Timbercorp with both receivers and administrators appointed. The secured creditors appointed the receivers over the RE and exercised the function of the RE. It was recognised in court that their control of the RE was based on the right of a receiver to do what is necessary or incidental to enforcing its security. In our view, this placed the receivers in a position of gross conflict in duties.

1.3.2. In preparation for the sale of the land, the secured creditors amended the appointment of the receivers to effectively retire from the RE. Within days, the receivers had issued default notices and then termination notices on the RE towards an eventual sale of the land.

1.4. Rewards Group

1.4.1. An active growers group promoted a deed of company arrangement for group entities working with the liquidators, but the secured creditors appointed receivers to all entities other than the RE and served lease termination notices.

1.4.2. The deed of company arrangement proposed to pay out the secured creditors in full, but despite this, the secured creditors rejected the arrangement and instead have undertaken their own sale process, which may or may not result in the secured creditors being paid out. The strategy of the secured creditors has been to rid the land of the interests of the growers so that they can sell free, unencumbered title to the purchasers.

1.4.3. At one stage the Rewards growers were contemplating applying to the Court for the appointment of a RE. However, the responsible entities who were approached to take on the role all raised the issue referred to in part 4.4.2 of the discussion paper, namely they were uncertain whether section 601FS of the Act would result in them being personally liable for scheme liabilities beyond the extent to which they could be indemnified from the assets of the scheme.

1.4.4. One potential replacement RE approached ASIC to exercise its discretion under part 5C.11 of the Corporations Act to make a modification order to ensure that the RE would not be personally liable, but ASIC refused to grant the modification. Had the modification order been granted, it is likely that a new RE would have been appointed and the RE would have negotiated with the secured creditors who could still realise the land subject to the rights of the tenant RE.

1.5. FEA

1.5.1. At no time have the receivers of the FEA companies asserted control over the RE. However, the receivers have claimed that monies received by the RE under the contract-based schemes are the property of the RE in its personal capacity rather than scheme property.

1.5.2. The totally inadequate documentation within the FEA group has led to so much uncertainty of the rights and liabilities of the companies of the failed group, that it has been impossible for a new RE to agree to an appointment until these uncertainties are resolved.

1.6. Willmott

1.6.1. In the Willmott insolvency, liquidators and receivers have been appointed over entities within the Willmott group of companies, included Willmott Forests Ltd (WFL), the RE of the Willmott Schemes. In this case, WFL also holds the legal title to a significant proportion of scheme land in its personal capacity, which it has leased directly to growers. We note that on the basis of expert evidence procured by the Willmott Group, it appears that a number of the plantations in the Willmott schemes are likely to be viable.

1.6.2. Willmott Growers Group Inc (WGG), an active growers group of growers in the Willmott schemes has sought to implement a proposal to replace the RE of the Willmott Forests 1995-1999 Project, which it considers viable, by seeking to convert the scheme from a non-contributory to a contributory scheme. However, the liquidators and receivers of WFL instituted separate legal actions which have to date prevented the WGG from effecting proposals to reconstitute potentially viable schemes.
1.6.3. In May 2011, the liquidators of WFL applied to the Federal Court for directions pursuant to section 511 of the Corporations Act that they are justified in procuring WFL to amend the constitutions of the managed investment schemes and disclaim the Project Documents of the schemes as onerous. In effect, the liquidators sought orders to facilitate the unencumbered sale of Willmott land in winding up the Willmott schemes, subject to preserving the growers’ entitlements to sale proceeds attributable to the termination of their rights. The Court granted the liquidators’ application, subject to the requirement that the liquidators must obtain leave of the Court prior to exercising its powers to disclaim Project Documents.

1.6.4. In June 2011, the receivers of WFL applied to the Supreme Court of Victoria seeking an interim and final injunction against WGG and other parties from passing resolutions that would affect WGG’s proposal. The substantive matter is based on an allegation that elements of the WGG proposal constitute a fraud on a minority of scheme members who are unable or unwilling to make further contributions to the scheme. The interim injunction was granted and subsequently extended on an interlocutory basis until the matter is tried, which will be at least December 2011.

1.6.5. The liquidators commenced its sales process relating to the Willmott schemes land, starting with an Expressions of Interest campaign. It is likely that the sales process will conclude before the receivers’ injunction can be lifted, which may have the effect of preventing growers of the 1995-1999 Project from implementing its (or any) proposal to continue the scheme. The conclusion of the sales process will also prevent any other groups of growers from continuing their schemes, restricting their rights to the apportionment of the proceeds to the sales process attributable to the termination of their rights.