Australian Government

Corporations and Markets Advisory Committee

Managed Investment Schemes

Discussion Paper

June 2011

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ISBN 978-0-9806747-7-4 (print version)
ISBN 978-0-9806747-8-1 (on-line version)

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1 Introduction

This chapter explains the background to the review, sets out the terms of reference, and invites submissions on any aspect of the reference, including the questions raised in subsequent chapters.

1.1 Background

The failure in recent years of a number of high profile managed investment schemes (MISs) and their responsible entities (REs) has highlighted the legal difficulties that can arise where this form of investment or entrepreneurial structure suffers financial stress.

In some situations, the financial failure of an RE may be the result of its dealings that are unrelated to its role as the operator of a particular, still viable, MIS. The future of that MIS may nevertheless be placed in jeopardy through difficulties in attracting a suitable replacement RE without delay. Alternatively, a potentially viable MIS may have to be wound up through the failure of its RE, without an opportunity for an independent assessment of the possibility of a compromise or other arrangement that could allow the MIS to continue with a new RE.

In other circumstances, the failure of an RE may also signal the non-viability of one or more of the MISs that it operates. In that case, questions arise as to the most appropriate procedures to ensure a suitable outcome for all affected parties in the liquidation of the RE and any affected MIS, without the level of procedural complexity and potential disputation that currently can beset this process.

Some of the problems that have arisen in practice were highlighted in the report by the Parliamentary Joint Committee on Corporations and Financial Services *Inquiry into aspects of agribusiness managed investment schemes* (September 2009) (the PJC report). That report referred to a number of concerns raised by affected parties following the financial collapse of these schemes and the appointment of an external administrator (liquidator, administrator or receiver), including whether their interests were properly recognised in the external administration process, whether potential conflicts for

insolvency practitioners conducting the external administration were resolved, and whether fair consideration had been given to continuing one or more MISs through restructuring arrangements for those schemes.[1]

The problems that have arisen in recent years in part reflect difficulties experienced in particular commercial sectors, or with particular MIS structures. However, they also point to a wider need to review the MIS legislative framework under Chapter 5C of the Corporations Act, to make it workable and relevant to current investment and entrepreneurial arrangements, taking into account developments in practice since the present legislation was introduced over a decade ago.

1.2 Reference to CAMAC

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

In his letter, the PST referred to:

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

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

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

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1 paras 3.99ff.

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

The PST letter also stated that:

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

The PST letter then referred various matters to CAMAC for consideration and provision of advice.

Transfer of a viable MIS

The PST letter asked CAMAC to:

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

These matters are discussed in Chapter 4.

Restructuring a potentially viable MIS

The PST letter asked CAMAC to:

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

These matters are discussed in Chapter 5.

Winding up a non-viable MIS

The PST letter asked CAMAC to:

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

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

These matters are discussed in Chapter 6.

Other matters concerning the regulation of MISs

The PST letter asked CAMAC to:

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

These matters are discussed in Chapter 7.

MIS structures

Two distinctions are central to a consideration of the matters referred to in this reference to CAMAC:

- the distinction between MISs that involve the pooling of member contributions for use as the property of the scheme (typically in trust-based 'investment' MISs) and MISs that do not involve pooling but rather the use of investor contributions in a common enterprise that constitutes the scheme (typically in contract-based 'enterprise' MISs). This has significant implications for differentiating the property of an MIS from property owned by individual investors but used in the operation of the MIS

- the distinction between sole function and multi-function REs. A sole function RE is an entity whose only role is to operate a single MIS, whereas a multi-function RE is an entity that operates a number of MISs and/or has dealings in its own right. This points to the importance of ensuring that the affairs of each MIS operated by a multi-function RE can be separately identified.

Clear and certain identification of the property and affairs of each MIS is fundamental in any situation involving the transfer of a

viable MIS, the restructuring of a potentially viable MIS, or the winding up of a non-viable MIS.

Taxation matters

CAMAC notes that the relative use of MIS and corporate structures in Australia for investment and commercial purposes, or a combination of these structures through 'stapled securities' arrangements,[2] is influenced by taxation considerations. Likewise, the particular structures of some MISs, including the extent to which members seek to be more than passive investors, can be traced to various taxation consequences.

The terms of reference do not include consideration of taxation issues concerning the use, or structure, of MISs.

Differences from PJC report

As indicated in the PST letter, the PJC report recommended a statutory amendment 'to require ASIC to appoint a temporary Responsible Entity when a registered managed investment scheme becomes externally administered or a liquidator is appointed'.[3]

The approach taken in Chapter 4 of this discussion paper is to consider the legal obstacles to suitable entities agreeing to act as a temporary responsible entity (TRE)[4] to operate a viable MIS where its former RE can no longer fulfil that role and a suitable replacement RE has not yet come forth.

The approach taken in Chapters 5 and 6 of this discussion paper is to consider the appointment of an administrator or liquidator to an MIS in financial stress (separate from any such appointment to the RE of that MIS).

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2 A stapled security is a type of financial instrument that combines shares in a company with units in an MIS. These combined securities can only be purchased and sold together. For instance, many property MISs have their units stapled to the shares of companies with which they are closely associated.

3 rec 2.

4 See the definition of 'responsible entity' in s 9 of the Corporations Act, which includes a reference to a temporary responsible entity (TRE).
All section references are to the Corporations Act unless otherwise stated.

1.3 Request for submissions

CAMAC invites submissions on any aspect of the matters coming within the terms of reference, including the issues raised and questions posed in each of the subsequent chapters of this paper.

Respondents are also encouraged to raise any other matters related to the operation of MISs that they consider call for legislative or other regulatory reform.

In preparing submissions, respondents are requested to draw distinctions between trust-based and contract-based MISs, where appropriate.

Respondents are also invited to draw attention to the regulation of the equivalent of MISs in any other jurisdictions, where relevant to matters raised in their submissions.

Please email your submission, **in Word format** (not pdf), to:

john.kluver@camac.gov.au

Word format is requested, as part of the internal CAMAC process for considering submissions involves their collation under topic headings.

If you have any queries, you can call (02) 9911 2950.

Please forward your submissions by **Friday 30 September 2011.**

All submissions, unless marked confidential, will be published at **www.camac.gov.au**. Submissions will be published in pdf format.

1.4 Advisory Committee

The members of CAMAC are:

- Joanne Rees (Convenor)—Chief Executive Officer, Ally Group, Sydney
- Belinda Gibson—Deputy Chairman, Australian Securities and Investments Commission
- David Gomez—Principal, Merit Partners, Darwin

- Jane McAloon—Group Company Secretary, BHP Billiton Limited, Melbourne
- Alice McCleary—Company Director, Adelaide
- Denise McComish—Partner, KPMG, Perth
- Marian Micalizzi—Chartered Accountant, Brisbane
- Michael Murray—Legal Director, Insolvency Practitioners Association, Sydney
- Geoffrey Nicoll—Co-Director, National Centre for Corporate Law and Policy Research, University of Canberra
- Ian Ramsay—Professor of Law, University of Melbourne
- Robert Seidler AM—Consultant, Blake Dawson, Sydney
- Greg Vickery AM—Special Counsel, Norton Rose Australia, Brisbane.

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

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

The members of the Legal Committee are:

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

The Executive comprises:

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

2 Current position

This chapter summarises the various types of MISs and the regulatory regime for these schemes.

2.1 Economic role of MISs

MISs are a means of pooling, or using in a common enterprise, wholesale and retail funds, including in:

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

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

The managed funds industry, which includes various types of MISs, forms a substantial part of the Australian economy.[5] For instance, listed MISs with a capitalisation of $116 billion constitute 8% of the total market capitalisation of securities listed on the ASX market.[6] Some 80% of investment-grade commercial real estate, comprising office buildings, shopping centres and industrial facilities, are held

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5 According to the Australian Bureau of Statistics, as at 31 December 2010, $1,793 bn were pooled for investment purposes in the managed funds industry, which includes listed and unlisted MISs. That figure covers the original pooling of funds but does not include the investment of such funds in schemes.

6 Approximately 68% of listed MISs are Real Estate Investment Trusts (REITS), with the remainder being infrastructure trusts, exchange-traded funds (ETFs) and Listed Investment Trusts.
Listed MISs are subject to various ASX Listing Rule requirements. A court may order that the RE of a listed MIS comply with the Listing Rules: s 793C.

in MISs. Most major infrastructure projects that use the public-private partnership (PPP) model utilise MISs.

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

The taxation of trusts in Australia is also more favourable to the use of collective investment vehicles than in other major jurisdictions, such as the United States and Japan. This factor, and the significant growth in superannuation funds under management because of the compulsory superannuation requirements in Australia and the need to invest such funds, are the major drivers of the burgeoning use of MISs in Australia.

For tax and other purposes, an enterprise may be conducted through a combined MIS/corporate structure. Under a simple 'stapled' arrangement, the company takes the active role of operating the enterprise, while the property of the enterprise is held passively through the MIS structure. Some stapled arrangements may involve multiple MISs or companies. Where more than one MIS is involved, they may have the same RE or separate REs.

2.2 Legislative framework

The current legislative structure for the regulation of MISs, primarily set out in Chapter 5C of the Corporations Act, was introduced by the *Managed Investments Act 1998* in response to the joint Australian Law Reform Commission (ALRC)/Companies and Securities Advisory Committee (CASAC)[7] report *Collective Investments: Other People's Money* (1993) (the ALRC/CASAC report).[8]

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

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

2.2.1 Legal structure of an MIS

Basic features

While there is no prescribed structure for an MIS, the various types of trust, contractual, limited partnership and other schemes have key common features, including:

- the contributions of members of the MIS either are to be pooled or, if not pooled, are to be used in a common enterprise. Members receive contractual or property 'interests' in the scheme, being 'financial products' regulated by Chapter 7 of the Corporations Act

- the scheme is operated by the RE,[9] given that an MIS is not a separate legal entity and therefore cannot enter into legal relationships in its own right

- investors do not have day-to-day control over the operation of the MIS (though they may have the right to be consulted or to give directions).[10]

The concept of 'scheme property' covers:

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

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

10 See the definition of 'managed investment scheme' in s 9 of the Corporations Act, which also sets out a number of specific exclusions. ASIC has pointed out that, in general, only investments that are 'collective' are MISs. Some examples given by ASIC of investments that are not MISs include:
- regulated superannuation funds
- approved deposit funds
- debentures issued by a body corporate
- barter schemes
- franchises
- direct purchases of shares or other equities
- schemes operated by an Australian bank in the ordinary course of banking business (eg term deposit). See www.asic.gov.au

rights in the property that the member retains do not form part of the scheme property[11]

- money borrowed or raised by the RE for the purposes of the scheme
- property acquired, directly or indirectly, with, or with the proceeds of, contributions or money referred to above
- income and property derived, directly or indirectly, from contributions, money or property referred to above.[12]

Despite this apparently wide definition, whether property used in connection with an MIS is 'scheme property' as defined may depend on whether the MIS is one in which members pool their funds or is one in which members use their funds in a common enterprise.

Pooled schemes and common enterprise schemes

The legislation does not mandate a particular legal structure. However, a distinction can be drawn between trust-based MISs, where the contributions of members are typically pooled, and contract-based MISs, where the contributions of members are typically used in a common enterprise.[13]

MISs that hold assets such as financial assets or real estate for investment purposes are generally structured as trusts, largely for tax reasons. In the listed property and infrastructure sectors, interests in trust-based MISs are often stapled to shares in an operating company. In these trust-based 'investment' type MISs, the contributions of scheme members are generally pooled and their interest is in the nature of a beneficial interest in the whole of the property of the trust.

In contrast, 'enterprise' type MISs are often structured as a series of bilateral executory contracts between the member, the scheme operator and various other entities. The 'scheme' in that case is not a

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11 Note 1 to s 9 definition of 'scheme property of a registered scheme'.

12 s 9 definition of 'scheme property'.

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

pool of assets under management, but rather the common enterprise carried out over time in accordance with those contracts. For instance, some agribusiness MISs, for taxation or other reasons, were structured to give members ('growers') various forms of proprietary or contractual interests related to the operations of the scheme on allocated parcels of land, which may be owned by a third party.[14] In that type of MIS, complex problems can arise in

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

> The Timbercorp group of companies went into administration on 23 April 2009. On 29 June 2009, the creditors voted at their second meeting for the companies to be wound up and the companies, which included the second defendant ("AL"), were placed into liquidation. ...
>
> Before liquidation, the Timbercorp group had established, managed and operated several horticultural managed investment schemes. These schemes had included managed investment schemes for the cultivation and harvesting of almonds for commercial gain. Five of the schemes (collectively "the Almond Projects") had used commercial almond orchards established by AL on its land, which AL made available for the purposes of the projects. Investors in these projects ("growers") subscribed for interests in "Almondlots", which carried rights to use and occupy AL's orchards for the terms of the projects of which they were members ("the growers' rights").
>
> All of the Almond Projects had many years left to run when the Timbercorp group went into external administration but the insolvency of the Timbercorp group had the consequence that the Timbercorp companies could not continue their involvement in the projects. The liquidators brought the projects to an end when they extinguished the growers' rights on 2 December 2009 so that they could sell AL's land, almond trees and water licences ("the Almond Assets") free of any encumbrance on title. ...
>
> ... At the time that the Timbercorp group was placed under administration, the group had thirty three managed investment schemes registered with the Australian Securities and Investments Commission ("ASIC") under Part 5C of the Corporations Act 2001 (Cth) ("the Act"). Timbercorp Securities Ltd ("TSL"), a wholly owned subsidiary of TL and the holder of an Australian financial services licence, was the responsible entity ("RE") of these schemes. ...
>
> The registered projects and the 2002 private offer project were conducted on AL's land and used AL's almond orchards and infrastructure, including its water licences and irrigation equipment. Although the legal structures differed, it was a key feature of each project that the Almond Assets remained AL's property. The project documents only gave growers rights to use and occupy AL's property for the terms of their projects for the purpose of cultivating and harvesting almonds.
>
> Growers participated in the projects by subscribing for Almondlots and paying a fee per Almondlot. Subscription was by application and the completion of a power of attorney. By signing the application the grower agreed to be bound by the constituent legal documents governing the project. By completing the power of attorney the grower appointed the attorney to enter into the applicable agreements underpinning the projects on the grower's behalf.

determining the nature of the rights of MIS members,[15] and what, if anything, constitutes the property of the scheme.

Trust and non-trust elements

There are some key trust elements that are applicable to all MISs, including contract-based schemes, in particular:

- the RE holds scheme property on trust for scheme members.[16] It has also been held that, in consequence, an RE is a 'trustee' for the purposes of the court's jurisdiction to provide judicial advice to an RE under relevant state trustee legislation[17]

- the RE's rights to recover from the property of the MIS for costs it has incurred in operating the scheme (and the ability of creditors of the RE, as operator of the MIS, to gain access to those rights in certain circumstances through subrogation) are derived from the constitution of the MIS and based on trust law indemnity principles.[18]

On the other hand, there are areas where the legislative scheme for MISs differs from the general law of trusts. For instance, the Corporations Act sets out a regime for the transfer of rights, obligations and liabilities where the RE of an MIS changes,[19] independently of any trust law principles applicable when there is a

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15 For instance, in *BOSI Security Services Limited v Australia and New Zealand Banking Group Limited & Ors* [2011] VSC 255, the Court held, on the facts, that the members of the MIS had only a contractual, not a proprietary, interest in certain land used in the operation of that MIS. Those contractual rights were insufficient to establish their entitlement to share in the proceeds of the sale of that land.

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

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

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

18 s 601GA(2).

19 ss 601FS, 601FT.

change of trustee.[20] Also, under general trust law, there is no such thing as the formal winding up of a trust. The trust simply comes to an end in certain circumstances and the property is distributed among the beneficiaries.[21] By contrast, the legislation regulating MISs contains specific provisions for the winding up of a scheme.[22]

2.2.2 Regulation of an MIS

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

Registration of an MIS

All MISs must be registered except for 'private' schemes and 'wholesale' schemes [23] (the discussion in this paper will deal with registered MISs except where otherwise indicated). Some registered MISs are also listed on the ASX.

Investing in an MIS

The process of offering interests in an MIS is regulated by various disclosure requirements, including that potential retail investors of registered MISs must be given a product disclosure statement, and other related documents, in advance of any investment.[24]

Role of the RE

An MIS cannot operate without an RE, which must be a public company that holds an Australian financial services licence.[25] The MIS must also have a scheme constitution,[26] a compliance plan[27]

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

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

22 Part 5C.9.

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

24 An interest in an MIS is a 'financial product' for the purposes of Chapter 7 of the Corporations Act (Part 7.1 Div 3). The disclosure requirements for financial products are set out in Parts 7.6 and 7.9. They contain detailed requirements for disclosure to a 'retail client' (as defined in ss 761G, 761GA).

25 s 601FA.

26 Part 5C.3.

27 Part 5C.4.

and, in some instances, a compliance committee.[28] A registered MIS may be deregistered by ASIC if it does not have an RE that meets these requirements.[29]

The legislation sets out responsibilities and powers of an RE,[30] the processes for changing the RE[31] and the consequences of any change of RE.[32]

The RE of an MIS must hold scheme property (as defined) separately from personal assets of the RE and the property of any other MIS.[33]

An RE, its officers and its employees are subject to various statutory duties in operating an MIS.[34] Directors of the RE may also be personally liable in some instances in operating the scheme.[35] Members of an MIS may have civil remedies where the scheme has been mismanaged.[36] An RE may also seek remedies on behalf of the members of the MIS in various circumstances, including where there has been a breach of trust by a former RE or its officers.[37] In addition, as an RE is a public company, its directors have the same

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28 Part 5C.5.

29 s 601PB(1)(a).

30 Part 5C.2 Div 1.

31 Part 5C.2 Div 2.

32 Part 5C.2 Div 3.

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

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

35 s 197.

36 See, for instance, ss 601MA, 601MB, 1324, 1325.

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

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

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

duties as the directors of any other company,[38] including a duty to prevent the RE from trading while insolvent.[39]

If the RE is to have a right to be paid remuneration out of the property of an MIS, that right must be specified in the scheme constitution and be available only in relation to the proper performance by the RE of its duties.[40]

The annual reporting requirements applicable to public and other companies also apply to MISs.[41] Likewise, the requirements for maintaining financial records applicable to companies apply to MISs.[42]

Replacement of the RE

There are procedures for replacing an RE, including the appointment of a temporary responsible entity (TRE) as an interim measure while a new RE is sought.[43] A common goal of these procedures is to avoid an MIS that is not in liquidation being without an RE for any period of time.

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.[44] The ostensible purpose of this provision is to ensure that the rights of creditors are not affected where the RE of an MIS changes.

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

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

40 s 601GA(2).

41 Part 2M.3.

42 Part 2M.2.

43 Part 5C.2 Div 2.

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

Position of members

By definition, members of an MIS have no day-to-day control over the operation of the scheme.[45] However, meetings of MIS members may be called for various purposes, including to change the RE,[46] to alter the scheme constitution,[47] to approve various related party financial benefits,[48] or to direct that the MIS be wound up.[49] There are statutory procedures for calling and holding meetings, as well as voting on resolutions and gaining access to the minutes of members' meetings.[50]

MIS members do not have an automatic right to inspect scheme accounts or other documents, unless this right is provided for in the scheme constitution or some other scheme document. However, the court may order that an MIS member have access to books of the scheme if the court is satisfied that the applicant is acting in good faith and that the inspection will be made for a proper purpose.[51] The court may also make ancillary orders, including restricting the use that a person who inspects the books may make of the information obtained.[52]

There is a statutory procedure for members seeking to withdraw from an MIS (including the freezing of withdrawal rights for non-liquid schemes).[53] There are also provisions dealing with certain contraventions by promoters or the RE.[54]

Restructuring

A reorganization or change of control of a company may be achieved through a scheme of arrangement under Part 5.1 of the Corporations Act. These provisions do not apply to managed investments schemes. Instead, changes of control or other reorganizations of managed investment schemes have tended to proceed through 'trust scheme' arrangements. There is no equivalent

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45 Definition of 'managed investment scheme' in s 9 of the Corporations Act.
46 s 601FM.
47 s 601GC(1)(a).
48 Part 5C.7.
49 s 601NB.
50 Part 2G.4.
51 s 247A.
52 s 247B.
53 Part 5C.6.
54 Part 5C.8.

in these arrangements of the judicial and other procedural protections applicable to corporate schemes of arrangement, though the proponents of a trust scheme may choose to seek judicial direction or advice on its implementation.

The CAMAC report *Members' schemes of arrangement* (2009) recommended the extension of the scheme of arrangement provisions to listed and unlisted MISs.[55]

2.2.3 The RE transacting as operator of an MIS

In trust-based MISs, the RE, when operating the scheme, will usually contract as principal (and therefore be personally liable), given that an MIS is not a separate legal entity. The MIS members will not be parties to those contracts. By contrast, in contract-based MISs, the RE may, depending on the terms of the scheme, not transact as principal, but as the agent for the members of the scheme, who are then personally liable to the counterparties as principals.

Where an RE is contracting as principal, the counterparty may agree to limit the RE's personal liability in some respect, for instance to the amount for which the RE can be indemnified from scheme assets.[56]

Rights of the RE

It has long been recognised that a trustee can resort to the property of the trust to discharge a liability that it has properly incurred as trustee of that trust.[57] A trustee can:

- apply the trust property directly in discharging the liability,[58] or
- itself discharge the liability and then exercise a right to be reimbursed from the property of the trust for the costs it has incurred.[59]

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55 Sections 7.2 and 7.6.2.
56 *JA Pty Ltd v Jonco Holdings Pty Ltd* [2000] NSWSC 147 at [50].
57 *Worrall v Harford* (1802) 8 Ves Jun 4.
58 In trust law this is described as the 'right of exoneration'.
59 In trust law this is known as the 'right of recoupment' or the 'right of reimbursement'.

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

> The trustee is entitled to be indemnified out of the trust assets in respect of liabilities which it incurs in the course of administering the trust, but is personally liable to creditors in respect of such liabilities unless it has contracted with a creditor to limit the creditor's recourse against it. If the trustee has discharged the liability out of his individual property, he is entitled to reimbursement from the trust fund. If he has not discharged it, he is entitled to be exonerated from the trust fund for the liabilities properly incurred in the administration of the trust. He cannot be compelled to surrender the trust property to the beneficiaries until his claim has been satisfied.[60]

These indemnification rights are available to an RE of an MIS if:

- they are specified in the constitution of the MIS, and
- the RE has properly performed its duties.[61]

The RE will not have an indemnity claim against the property of the MIS if the RE has acted beyond power (including outside the terms of the MIS constitution) or otherwise improperly.[62] This statutory limitation on an RE's right of indemnity is reinforced by the general law limitation whereby a trustee's right of indemnity is subject to, and diminished by, any lawful claim by beneficiaries against the trustee in connection with breaches by the trustee, for instance, misappropriation, or neglect, of scheme property.[63]

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

61 s 601GA(2).

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

63 See N D'Angelo, 'The unsecured creditor's perilous path to a trust's assets: Is a safer, more direct US-style route available?' (2010) 84 *Australian Law Journal* 833 at 841.

Any attempt in a scheme constitution or otherwise to deny an indemnity right otherwise given in the constitution because the RE of an MIS has gone into external administration is void.[64]

Rights of secured counterparties

A creditor can enforce any security lawfully granted to it by an RE when acting, as principal or agent, in any capacity.

Rights of unsecured counterparties

Unsecured counterparties to transactions where the RE has contracted as agent for the MIS members have remedies against those members.

Counterparties to transactions where the RE is contracting as a principal (whether in the capacity of operator of a particular MIS or otherwise) have rights against the personal assets of the RE. They do not have a direct claim on the property of any MIS operated by that RE, which is held in trust by the RE.[65]

Whether a counterparty has additional legal avenues to obtain payment of its debt depends on the capacity in which the RE has acted a counterparty. There is no presumption in law that a company is acting in any capacity other than on its own behalf. Where an RE enters into a transaction, consideration may need to be given to the terms of the transaction and other surrounding circumstances to determine whether the RE has contracted as operator of a particular MIS.[66]

Counterparties to transactions where the RE has acted as operator of a particular MIS, though they have no direct right against the property of that MIS, may seek subrogation to the RE's indemnity

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

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

66 This is based on trust law principles, as set out in *Re Interwest Hotels Pty Ltd (in liq)* (1993) 12 ACSR 78.

rights against the property of the MIS.[67] This derivative basis for making a claim can give creditors only the same rights as the RE against scheme property. 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. Furthermore, the amount recoverable by creditors under the RE's right of indemnity is subject to, and may be diminished by, claims by MIS members, as trust beneficiaries, in connection with any breaches by the RE, not just in connection with breaches relating to the debt incurred to the relevant creditor.[68]

One consequence of the application of these indemnity and subrogation principles is that improper conduct of the RE will prevent counterparties whose claims have not been discharged by the RE from obtaining payment out of the property of the MIS. One judge, speaking extra-judicially, has summed up the position in the context of trusts:

> The trustee's [indemnity] rights ... are fragile things. And their fragility may rebound upon creditors. The beneficiaries' interest in trust property will not be postponed to a beneficial interest of the trustee unless the trustee's interest exists. If the trustee's interest does not exist, the trust property is shielded from the claims of the trustee's creditors.[69]

Creditors may also be disentitled from claiming against scheme property by their own behaviour. One commentator[70] has summed up the position as follows:

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

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

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

69 RI Barrett, 'Insolvency of registered managed investment schemes', Paper delivered at the Conference of the Banking and Financial Services Law Association, Queenstown, July 2008), p 5.

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

> conscience of the trustee.[71] Being a creature of equity, it is discretionary and subject to all the usual rules for engaging equitable remedies. This means that an enforcing unsecured trust creditor may be denied subrogation by application of disentitling equitable defences such as unconscionability, laches, acquiescence, waiver, estoppel, clean hands, or who comes to equity must do equity. Potentially, parties with something to gain (for example, the beneficiaries or even competing trust creditors) could manoeuvre to deny an unsecured trust creditor its claim to subrogation and, therefore access to the trust assets, by seeking to demonstrate disentitling behaviour on the part of the creditor, leaving it to its rights against the trustee personally and a share out of the trustee's personal assets (if any) in liquidation.

Position of MIS members

MIS constitutions usually exempt scheme members from liability to indemnify the RE for costs it has incurred in operating the scheme. If not, however, the RE may have a right of indemnity against those members for those costs.[72]

2.2.4 External controls

The RE of a listed MIS is under a continuing obligation to notify the market of any material price-sensitive information concerning the scheme that is known to the RE but is not generally available.[73]

The takeover and compulsory acquisition provisions in Chapters 6, 6A and 6B of the Corporations Act apply to the acquisition of interests in listed MISs.[74] Also, attempts to entrench an RE of a listed trust may amount to 'unacceptable circumstances' for the purposes of Chapter 6.[75]

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

72 In *Fitzwood Pty Ltd v Unique Goal Pty Ltd* [2002] FCAFC 285, the unitholders in a private unit trust were held liable to indemnify the trustee. See further the CASAC report *Liability of Members of Managed Investment Schemes* (March 2000), available under 'Publications' on the CAMAC website www.camac.gov.au

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

74 s 604. See also Takeovers Panel *Guidance Note 15: Trust Scheme Mergers*.

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

ASIC has a range of powers under Chapter 5C, including to make various exemption and modification orders,[76] to undertake surveillance checks of REs,[77] to require modification of a compliance plan,[78] and to apply to the court to have an MIS wound up.[79] ASIC also has a range of investigative and other powers, including pursuant to the licensing regime for the RE[80] and its general information-gathering powers under the ASIC Act.[81]

2.2.5 Winding up an MIS

Historically, little consideration was given to the winding up procedures for an MIS, particularly when schemes were more in the nature of securities or other investment portfolios, with no significant creditor involvement. However, the approach in Australia over the years, driven in part by taxation considerations and the growth of superannuation funds under management, has been to expand the role of MISs into activities similar to companies.

The procedures for the external administration of an MIS that were introduced in 1998[82] primarily envisaged the RE conducting the winding up, with a residual general power of the court to 'appoint a person to take responsibility' for the liquidation of an MIS if the court 'thinks it necessary to do so'.[83] The legislation did not implement the recommendations in the ALRC/CASAC report for a comprehensive MIS voluntary administration, as well as liquidation, framework similar to that for companies. Neither the second reading speech for the *Managed Investments Bill 1997* (Cth), which introduced Chapter 5C into the Corporations Act, nor the Explanatory Memorandum provided an explanation for this omission.

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76 Part 5C.11.
77 s 601FF.
78 s 601HE.
79 ss 601ND, 601NF.
80 See, for instance ss 912C-912E.
81 Part 3 of the ASIC Act.
82 Part 5C.9. Part 5C.10 deals with the deregistration of an MIS.
83 Part 5C.9, including s 601NF.

3 Proposed key legislative reforms

This chapter considers the need for legislative reforms that identify the affairs of each MIS, place controls on the use of scheme property, and stipulate the rights of creditors. The proposed reforms are applied in subsequent chapters in the context of a consideration of possible procedures for transferring viable MISs, restructuring potentially viable MISs and winding up non-viable MISs. The chapter also discusses some related issues concerning the identification of scheme property and member transactions and the consequences of tort claims.

3.1 Need for legislative reforms

Much of the complexity, disputation, delay and costs that have surrounded the external administration of some managed investment schemes in recent years can be traced to failure by REs to ensure adequate separation of the affairs of each of the MISs that they operate, as well as legal uncertainty regarding the position of parties dealing with REs as operators of various schemes.

In part, these problems arise from the fact that various MIS structures involve REs operating numerous MISs, which in turn may form part of a more complex MIS/corporate 'stapled' arrangement. The more complex the MIS structure, the greater the risk of entanglement of the affairs of different MISs and confusion over the rights of investors and outside parties.

The difficulties that can arise in disentangling the affairs of different MISs point to the need to ensure, from the time each MIS is established, that its affairs can be clearly identified and that those whose dealings with an RE involve that MIS can have a clear understanding of their legal position. Recent experience points to the shortcoming of waiting until MIS structures encounter financial stress before attempting to deal with these issues.

3.2 Sole function and multi-function REs

The current legislative framework focuses on a single MIS operated by its RE. It is drafted principally from the perspective of the MIS, with the provisions relating to the role of its RE focusing primarily on the RE's conduct of that MIS.

The role of the RE is central to the operation of MISs and the rights of third parties. As an MIS is not a separate legal entity, it cannot transact in its own right. Generally, transactions affecting an MIS are entered into by its RE, as operator of that scheme. In a contract-based MIS, the RE may contract personally or as agent for the members of the MIS. In a trust-based MIS, the RE contracts personally, in its capacity as trustee for scheme members.

An RE may be incorporated solely for the purpose of operating a single MIS, with all of its dealings attributable to its operation of that MIS (sole function RE). However, it is common for an RE to operate a number of MISs, and possibly also conduct other commercial activities in its own right without any relationship to the operation of any of its MISs (multi-function RE). An RE may therefore, over time, enter into a series of transactions as operator of different MISs.

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

- 40% of REs operating one MIS
- 30% of REs operating more than one, but less than 5, MISs
- 25% of REs operating 5 or more, but fewer than 50, MISs
- 5% of REs operating 50 or more MISs.[84]

A multi-function RE may be an 'internal' RE, set up for the purpose of operating an enterprise that involves a number of related MISs. There are also multi-function 'external' REs, which operate MISs in a range of different enterprises. In addition, an RE may be part of an

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[84] This information is provided by ASIC, which indicated that in May 2011 there were 549 registered REs operating approximately 4,600 registered MISs.

interconnected series of MISs (with different REs involved on behalf of one or more of the other MISs) that are all part of one operation or transaction ('interconnected MISs').

3.3 Problems in practice

The use of multi-function REs to operate MISs can create problems and uncertainties about identifying the affairs of each MIS that have not been fully addressed in the legislation, which gives only limited recognition to this type of RE.[85]

It is also necessary to ensure a clear distinction between arrangements entered into by an RE as a principal in operating a particular MIS and those entered into by the RE as agent for the members of the MIS.

3.3.1 Need to identify the transactions attributable to each MIS

There is some recognition in the legislation that an RE may operate more than one MIS, in that an RE is obliged to keep separate the property of each MIS that it operates.[86] However, except where the RE acts as the agent of the members in some contract-based schemes, the RE will transact as principal when operating an MIS, as an MIS is not a legal entity. An RE has no statutory obligation to identify for which MIS (if any) it is acting when it enters into transactions as principal.

The need for this information can arise in various contexts. For instance, a multi-function RE may wish to transfer responsibility for operating one or more of its MISs to a new RE, or the members of a particular MIS may seek to replace the RE. In either case, it is necessary to determine which of the accumulated rights, obligations and liabilities of the outgoing multi-function RE, when acting as a principal, attach to each affected MIS, given that they will transfer to

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

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

the incoming RE of each MIS.[87] The legislation simply assumes that it is possible to identify the relevant documentation for each MIS, for the purpose of a deemed novation of the contracting parties.[88]

The proposed legislative reforms set out in Section 3.4 seek to ensure the separation of the affairs of each MIS, for the purpose of identifying the rights, obligations and liabilities of each MIS.

3.3.2 Financial stress of a multi function RE

Where a multi-function RE goes into external administration, creditors will be concerned to know their standing in that process, including against whom, or in relation to what property or other assets, they can claim.

Secured creditors

A creditor can enforce any security lawfully granted to it by an RE when acting, as principal or agent, in any capacity. In this context, there is no difference whether the security was provided by a sole function or a multi-function RE, provided the RE was acting within power.

Unsecured creditors

RE transacting as agent

Where an RE has entered into transactions solely as the agent for members of an MIS (as in some contract-based schemes), counterparties will have remedies against those members. The external administration of the RE would not affect the exercise of those rights.

RE transacting as principal

Where a multi-function RE has entered into a series of transactions as principal and subsequently goes into external administration, the task of identifying which assets held by the RE are available for which claims by counterparties of the RE can become more difficult.

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

88 s 601FT.

The property of a multi-function RE in external administration can include all or some of the following:

- unexercised indemnity rights of the RE against the property of one or more of those MISs
- other property held by the RE in its own right (for instance, assets acquired through dealings unrelated to its operation of any MIS)
- property of one or more MISs operated by the RE.

Unsecured creditors who have dealt with the RE (regardless of in what capacity) do not have a direct right against any property of an MIS held by the RE. Rather, those counterparties who have dealt with an RE as operator of a particular MIS may seek subrogation to the indemnity rights of the RE against the property of that MIS. All counterparties of the RE are entitled to claim against assets of the RE held in its own right, unless they have agreed otherwise. An RE, when contracting as the operator of a particular MIS, may seek to limit its liability to its right of indemnity against the property of that scheme.

As previously indicated (Section 2.2.3), in certain instances, an indemnity claim is not available to an RE. The purpose of the general law restrictions on the right of indemnity is to protect the interests of beneficiaries of a trust where the trustee has acted beyond power or otherwise improperly.

It may be appropriate for the RE itself, while it is solvent and can pay its creditors, to have to bear the consequences of not having indemnity rights through its own conduct. 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.

In this respect, a contrast can be drawn with the ‘indoor management’ rule for companies, the effect of which is to maintain the rights of creditors to claim against the assets of the company,

even where the person acting ostensibly on behalf of the company was acting fraudulently or otherwise beyond power.[89]

Where an RE goes into external administration, uncertainty remains about who can claim against property recovered by the RE through the lawful exercise of its indemnity rights. One line of trust law authority is that, in the insolvency of a trustee, funds recovered under the trustee's right of indemnity out of property of any trust should be available for all creditors of that trustee.[90] Another line of authority is that, in the first instance, those funds should be available only for those creditors who have dealt with the trustee as trustee of that particular trust.[91]

3.3.3 Possible legislative initiatives

An ability to identify the affairs of each MIS and determine the rights of parties dealing with an RE as operator of the MIS is important both for the current MIS regulatory framework and also for the consideration of possible legislative initiatives discussed in subsequent chapters of this paper relating to viable, potentially viable or insolvent MISs.

For instance, in any move to replace an RE of a viable MIS, including the appointment of a TRE (discussed in Chapter 4), it is necessary to identify the affairs of that MIS, including for the purpose of determining the rights, obligations and liabilities of the outgoing RE concerning that particular MIS.

Likewise, any legislative initiative to introduce a voluntary administration procedure for a potentially viable MIS (discussed in

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89 ss 128, 129.

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

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

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

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

Chapter 5) or a separate liquidation procedure for a non-viable MIS (discussed in Chapter 6) would require the identification of those persons who could be characterised as the creditors of that MIS for certain purposes, including voting on a proposed deed of arrangement for the MIS or claiming against the property of that MIS in its liquidation.

3.4 Proposed legislative reforms

3.4.1 Purpose of the reforms

The proposed legislative reforms seek to respond to the issues raised above, which can significantly affect the operation of viable, potentially viable and non-viable MISs. They are intended to apply to all MISs from the commencement of their operations. They are in addition to other possible legislative changes raised for consideration elsewhere in this paper, which have more specific application.

The overall intent of the legislative reforms is to:

- identify the affairs of each MIS that an RE operates
- place controls on the use of scheme property
- set out the rights of creditors of each MIS.

These legislative reforms are also central to the process of treating MISs in a similar manner to corporations, particularly in relation to their external administration, as discussed in Chapters 5 and 6.

Proposed legislative Reforms 1 and 4 deal with arrangements where the RE is acting as principal as operator of an MIS. Arrangements under which the RE is acting as the agent for the members of the MIS (as in some contract-based schemes) are considered in Section 3.6.

The claims of creditors under the proposed legislative reforms would be subject to any rights that a secured creditor may have over affected property.

The reforms would apply regardless of any contrary agreement or provision in the scheme constitution.

Any general law principles that are inconsistent with the proposed legislative reforms would cease to apply in the context of MISs.

3.4.2 The proposed legislative reforms

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

Identification of agreements

Whenever an RE, as operator of an MIS, is a principal to a legally enforceable contract, arrangement or understanding ('agreement'), the RE must specify that this is the case and identify the MIS to the counterparty. The RE must include that information in any document constituting that agreement. Where the agreement involves more than one identified MIS, the RE must identify what part, or proportion, of the agreement is attributable to each MIS.

Recording of agreements

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

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

The agreements register must be maintained throughout the life of the MIS, and be available to any external administrator of that MIS. No agreement, whether or not still on foot, may be deleted from the register (except where recorded by mistake).

Explanatory note

This proposed reform seeks to ensure that agreements entered into by an RE as principal in operating an MIS are clearly identified and recorded. This contrasts with agreements entered into by an RE as agent for members of the MIS, which are considered elsewhere (see Section 3.6).

The agreements register would provide a means to trace the way an RE has operated that MIS. It would also assist a potential replacement RE in undertaking due diligence on the affairs of an MIS, for the purpose of the transfer of the rights, obligations and liabilities on any change of RE.

Failure to record agreements

The implications of an RE failing to record an agreement in an agreements register need to be taken into account in any move to introduce such a register.

On one view, the process of changing the RE of an MIS would be assisted if the incoming RE could rely on the register as a definitive record of all agreements involving any former RE, for the purpose of the transfer of rights, obligations and liabilities to the new RE. Counterparties to agreements not recorded in the register would not have any remedy against the new RE, but would retain their rights against the former RE as the counterparty to those agreements.

A contrary view is that the legal position of a counterparty should not be affected by any breach by an RE of its duty to maintain the register. Likewise, benefits that the members of an MIS may receive in consequence of an agreement entered into by an RE as operator of that MIS should not be jeopardised by the RE's failure to record that agreement.

Questions

Should the policy approach in Reform 1 be enacted?

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.

Reform 2: use of scheme property

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

Explanatory note

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

The constitution of an MIS must make adequate provision for various matters, including the powers of the RE in relation to 'making investments of, or otherwise dealing with, scheme property'.[92] A view has been taken that an RE may validly deal with property of the MIS in any manner permitted in the constitution, including, for instance, using property of the MIS to pay debts incurred by the RE in operating another MIS. Reform 2 would make clear that this conduct is prohibited. It would not be relevant that the RE may otherwise become insolvent. If the RE was unable to continue as operator of the first MIS because of those debts, a replacement RE of that scheme could be sought (including through the procedure discussed in Chapter 4).

Questions

Should the policy approach in Reform 2 be enacted?

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

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92 s 601GA(1)(b).

Reform 3: informing MIS creditors of a change of RE

Where the RE of an MIS changes, the new RE must give notice of that change to all counterparties included in the 'continuing agreements' section of the agreements register referred to in Reform 1, and to any other counterparty of which the new RE is aware or becomes aware.

Explanatory note

This proposed reform would help to ensure that persons who have transacted with an RE as the operator of a particular MIS, where any rights, obligations or liabilities of any party to that agreement are still on foot, are notified of the current RE of that MIS. This information would assist those parties with any claim against the RE.

Questions

Should the policy approach in Reform 3 be enacted?

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

Reform 4: rights of MIS creditors against scheme property

Only persons who have entered into an agreement with an RE as principal in its capacity as the operator of a particular MIS, and the RE in respect of its indemnity and other rights against the property of that MIS, will be the creditors of that MIS.

Persons who have transacted with the RE in this capacity will have the right to claim directly against the property of that MIS, not through subrogation to the RE's right of indemnity against scheme property.

Explanatory note

This proposed reform deals with the rights of MIS creditors against scheme property where they have contracted with the RE as principal in its capacity as operator of the scheme. It would not apply where the RE is only acting as agent for the members (as may be the

case in some contract-based schemes), in which case creditors would have remedies against the members themselves (see Section 3.6).

This proposed reform involves a fundamental change from the current position concerning the recovery rights of creditors of an MIS. At the time that 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.

Currently, under trust law principles applicable to MISs (see Section 2.2.3), creditors have no direct rights against the property of the MIS. They depend on being able to obtain access to that property through subrogation to the indemnity rights of the RE against that property. In consequence, the claims of these creditors are affected by any actions of the RE that may affect its indemnity rights, for instance where it acts beyond power. The current law therefore preserves scheme property for the benefit of MIS members whenever the RE has not properly performed its duties.

Reform 4 would give creditors a direct right against scheme property, applicable whether or not the RE was acting within power in entering into an agreement. In this respect, the reform would more closely align the rights of MIS creditors with those of corporate creditors (pursuant to the indoor management rule, as discussed in Section 3.3). 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.

Reform 4 would not affect the current limitations on an RE's exercise of its indemnity rights.

Any funds recovered by the RE from the property of an MIS through exercise of its indemnity rights would form part of the general assets

of the RE, available for all its creditors in the event of the liquidation of the RE.[93]

Related provisions

1: Rights of MIS creditors against assets of the RE

In addition to their rights under Reform 4, all counterparties to arrangements with an RE as principal that refer to a particular MIS (as per Reform 1) may claim against any property of the RE that is not held in trust by the RE, except for those counterparties who agree to limit their rights of recovery to Reform 4. Property of the RE not held in trust would include any indemnity rights of the RE against the property of any MIS.

2: Rights of other creditors of the RE

Where an RE as principal enters into arrangements that do not refer to a particular MIS (as per Reform 1), the rights of counterparties are confined to property of the RE that is not held in trust by the RE.

Questions

Should the policy approach in Reform 4 be enacted?

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)?

Should the two related provisions also be adopted?

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93 The principle in *Re Suco Gold Pty Ltd* (1983) 33 SASR 99, set out in footnote 91, would not be relevant in this context, given that Reform 4 would give MIS creditors a direct right of recovery against scheme property. *Re Suco Gold* concerns the recovery rights of trust creditors through subrogation to the indemnity rights of the trustee.

3.4.3 Application of the proposed legislative reforms

General application

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.

While an MIS is a going concern, an RE that has transacted as principal in its capacity as operator of a particular MIS can apply scheme property directly in discharging a counterparty claim, or itself pay the claim and then be reimbursed from the property of the MIS by exercise of its indemnity rights. This practice would be reinforced by Reform 4, which retains the indemnity rights of the RE.

The proposed reforms will have a significant impact on the regulation of MISs in situations of financial stress. Where the RE is insolvent (whether or not the insolvency is related to the financial viability of a particular MIS), all counterparties to transactions into which the RE has entered as principal in its capacity as operator of a particular MIS, and the RE in regard to any lawful unsatisfied indemnity or remuneration claims against the property of that MIS, would be the creditors of that MIS (Reform 4), including for the purpose of any voluntary administration or liquidation procedure for that MIS. The claims of counterparties, being direct rather than derivative through subrogation, would not be affected by any limitations on the RE's exercise of its indemnity rights.

Application to service providers

A person may enter into a service contract with an RE, either as an employee of the RE or as an independent contractor.[94]

An employee of an RE would, in that capacity, be a creditor of the RE for any unpaid entitlements. He or she would not be a creditor of an MIS for the purpose of Reform 4 merely because part of that

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[94] There are various common law tests to distinguish between employment under a contract of service (employee) and provision of services under a non-employee contractual arrangement (independent contractor). The court will look at the whole circumstances of the relationship between the parties when deciding whether an employment relationship exists.

person's duties as an employee of the RE may have involved the affairs of the MIS.

Whether an independent contractor is a creditor of the MIS or only of the RE would depend upon the terms of the contract. A contractor would be a creditor of a particular MIS only if the terms of the contract made clear that, in respect of the whole or a specified proportion of the contractual arrangement, the RE was acting as the operator of that MIS.

Creditor remedies against MIS members

A separate question concerns the circumstances, if any, in which creditors might have remedies against the members of an MIS (beyond those circumstances where the RE has acted as agent for the members under a contract-based scheme: see further Section 3.6).

Various reviews have recommended statutory provisions to the effect that the members of an MIS (other than one where the RE acts as agent for the MIS members) should have limited liability for scheme debts that remain outstanding on the winding up of the MIS, in the same manner as shareholders of a company limited by shares.

This matter is further discussed in Section 7.3.

3.5 Identifying scheme property

The RE of an MIS must hold scheme property (as defined) separately from personal assets of the RE and the property of any other MIS.[95]

As previously indicated (Section 2.2.1), some contract-based MISs may involve complex property arrangements with scheme members, making it difficult in some instances easily to distinguish scheme property from non-scheme property.

The clear identification of the property of an MIS (and changes to that property) is important to various parties. All REs, including a

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[95] s 601FC(1)(i) and the definition of 'scheme property' in s 9. The compliance plan of a scheme must set out the arrangements for ensuring that the requirement for separation of assets is complied with (s 601HA(1)(a)).

new RE, need to be able to identify property against which they can exercise their indemnity rights. Members may have residual rights to that property in the liquidation of an MIS. Also, Reform 2 would place controls on the lawful use of 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?

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

3.6 Identifying member transactions

Arrangements into which an RE enters as principal when operating an MIS are dealt with in Reforms 1 and 4. However, various contract-based MISs may involve the RE entering into contracts or other arrangements as agent for the MIS members. In these cases, only the members would be subject to the rights, liabilities and obligations that may arise under those arrangements.

To assist the process of identifying the full scope of transactions that may be involved in the operation of an MIS (including for the purpose of a possible VA of that MIS, as discussed in Chapter 5), there may be a benefit in requiring an RE to maintain a register of all legally enforceable agreements related to a particular MIS into which the RE has entered as agent of the MIS members.

This register of arrangements entered into by the RE as agent for the MIS members would complement the register in Reform 1, which covers arrangements where the RE has acted as principal as operator of the MIS.

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?

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

3.7 Tort claims and statutory liability

In some cases, persons may suffer injury or other detriment from which a claim in tort could arise in circumstances related to the operation of a particular MIS. For instance:

- a person having no legal relationship with the RE may be injured while upon land that is property of an MIS
- an owner of real property that is adjacent to land that forms part of the property of an MIS may suffer detriment in consequence of the escape of a substance or livestock from that land.

An RE may also breach occupational health and safety, consumer protection or other laws in operating an MIS.

An RE may be personally liable where, for instance, it can be established that an injury, loss or other detriment was suffered in circumstances where the RE had breached a common law duty or a statutory obligation. The RE may be entitled to be indemnified for that liability from the property of the MIS, provided its conduct was not a breach of the 'proper performance of its duties'.[96] An RE has specific duties in operating an MIS.[97] However, uncertainty can remain about the circumstances in which breaches by an RE of other general or statutory laws would constitute failure properly to perform its duties, for the purpose of denying the indemnity right of the RE against scheme property.[98]

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96 s 601GA(2).

97 s 601FC.

98 In *Gatsios Holdings v Kritharas Holdings (in Liquidation*) [2002] NSWCA 29, damages were awarded against the trustee of a trading trust in consequence of the trustee having breached consumer protection laws in the course of carrying on the business of the trust. The Court held that the trustee's breach did not deny it the right to claim against trust property to cover the damages.
A more restricted approach to the right of indemnity was taken in *Nolan v Collie & Merlaw Nominees Pty Ltd (in liq)* [2003] VSCA 39. The Court expressed a concern [at 45] that 'mischievous trustees might seize upon an almost unfettered right to indemnity as justifying improper depredations of trust funds, contrary to their obligation not to abuse their position'.

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?

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

4 Transfer of a viable MIS

This chapter discusses the question in the terms of reference whether the current temporary responsible entity (TRE) framework enables the transfer of a viable MIS business where the original RE is under financial stress, and, if not, whether that framework should be reformed or replaced. It considers this issue in the broader context of the various means by which the RE of a viable MIS may be replaced, the possible role of the TRE in that process, the implications for the transfer of rights, obligations and liabilities of a change of RE, and whether some remuneration arrangements for REs may inhibit that transfer process.

4.1 Problems in practice

An RE may be operating an MIS that is financially sound. The RE may become financially distressed for other reasons (such as liabilities it incurred as the operator of other MISs that are now insolvent, or in its other dealings) and may no longer be able to operate the MIS. As an MIS cannot operate without an RE, a replacement RE will be needed for the viable MIS to continue.

The intended purpose of the TRE is to operate a viable MIS in an interim capacity, following the inability of its RE to continue in that role, until a new RE can be found and appointed.[99]

The TRE appointment procedure has rarely been used in practice. One problem may be the limited circumstances in which a TRE can be appointed. However, the principal reason appears to be the lack of suitable entities willing to undertake that role, given that a TRE, like any other RE, becomes subject, under s 601FS, to the outstanding obligations and liabilities that the former RE incurred in operating the scheme, while also being subject to various statutory duties as the new operator of the scheme.[100] In practice, eligible entities are usually unwilling to consider becoming a TRE without an

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[99] s 601FQ.
[100] The s 9 definition of 'responsible entity' includes a specific reference to a TRE.

opportunity to conduct prior due diligence on the financial and other consequences of accepting that role. Particularly where the appointment of a TRE is a matter of urgency, a viable MIS may be in jeopardy because of the lack of a willing and suitable entity to take up the office of TRE on short notice.[101]

Reform 1[102] seeks to assist in the identification of the affairs of a particular MIS. This information may expedite the due diligence process for a party contemplating becoming the new RE of that MIS. In some cases, this may help achieve a direct transfer from an outgoing to an incoming RE. However, circumstances may remain where the former RE ceases to exercise that role without a replacement RE being available at that time. In these cases, there continues to be a need for a TRE to operate the MIS in the interim period while a new RE is sought and appointed.

Other problems that can arise in the process of changing an RE concern the determination of what rights, obligations and liabilities will transfer to an incoming RE and the remuneration rights of that entity.

4.2 Changing the RE

4.2.1 Overview

An MIS cannot be registered, or continue to operate, without an RE, which must be a public company that holds an Australian financial services licence (AFSL) authorising it to operate an MIS.[103]

In some cases, the transfer of the operation of a viable MIS from one RE to a new RE may proceed without difficulty, particularly where there is adequate time for an intending RE to conduct due diligence and the incumbent RE assists in that process. If a new RE is appointed, the former RE is required to hand over relevant books to the incoming RE and otherwise provide reasonable assistance to

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101 The reasons for the reluctance of parties to undertake the role of TRE are also discussed in D Walter, 'Managed investment schemes' (2011) 23(1) *Australian Insolvency Journal* 12.

102 Section 3.4.2.

103 ss 601EB(1)(d), 601FA, 601FK.

facilitate the change of RE.[104] Upon the change, a deemed novation of relevant documents also takes place as part of the deemed transfer of the rights, obligations and liabilities of the former RE to the new RE.[105]

In other situations, an RE may wish to retire from that role or be no longer eligible or suitable to operate the MIS, or the MIS members may wish to replace the RE without there being an eligible entity willing at that point to become the new RE. In these circumstances, there is a question about the suitability of the current powers to appoint a TRE to operate a viable MIS as an interim measure until a new RE can be found.

Only a court can appoint a TRE. The court may act where it has jurisdiction to do so (see Section 4.2.2), if it is satisfied that the appointment is in the interests of the members[106] and there is an eligible entity willing to act as a TRE. A TRE, like any other RE, must be a public company that holds a licence to operate an MIS.[107]

4.2.2 Where application can be made for appointment of a TRE

Voluntary retirement of the RE

An RE may wish to retire from that role. It can initiate the replacement process by calling a meeting of scheme members, but cannot resign in the absence of a willing and eligible replacement RE that has been approved by those members.[108] In the absence of a replacement RE, the current RE (through its liquidator if the RE is in liquidation) can apply to the court for the appointment of a TRE to the scheme.[109]

Ineligibility to remain as RE

If the RE of an MIS no longer meets the statutory requirements to be an RE (for instance, if the AFSL of the RE is withdrawn for any reason, including that the RE has gone into external

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104 s 601FR.
105 ss 601FS, 601FT.
106 s 601FP.
107 ss 601FA, 601FK.
108 s 601FL(1).
109 s 601FL(3).

administration[110]), ASIC or a scheme member may apply to the court for the appointment of a TRE.[111]

General provision

A member of an MIS, or ASIC, may apply to the Court for the appointment of a TRE if the applicant:

> reasonably believes that the appointment is necessary to protect scheme property or the interests of the members.[112]

The ambit of this provision is uncertain. For instance, an RE may become financially distressed for reasons unrelated to its operation of a particular MIS, which may remain viable. The RE may no longer be able effectively to operate the MIS, but there may be no new RE on hand. An applicant might argue that the appointment of a TRE is necessary to protect scheme property or the interests of members of the MIS.

A matter that has not been considered by the court is an application under this provision to appoint a TRE where the members have voted to remove an RE, but without being able to appoint a new RE (see Section 4.2.3). The unresolved issue is whether the court could appoint a TRE to replace the RE and have the MIS continue to operate, in the face of the statutory obligation of the RE to wind up the MIS where members do not appoint a new RE.[113] On one view, the explicit statutory obligation to wind up would not be overcome by the appointment of a TRE. A contrary view is that the appointment of a TRE would overcome the rationale behind the statutory obligation to wind up the MIS (namely that each MIS must have an RE).

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

111 s 601FN.

112 Corp Reg 5C.2.02. This general provision does not include a power for the court to act pursuant to the application. This creates some doubt about the court's powers if such an application were made.

113 s 601NE(1)(d).

4.2.3 Where application cannot be made for appointment of a TRE

Dismissal of the RE by the members

MIS members may by resolution, at any time, replace an RE, if there is an eligible entity[114] willing to undertake that role.[115] To do so, members holding at least 5% of the total voting rights of members may call a meeting of members[116] to consider and vote on a resolution that the RE be removed and a resolution choosing a new RE. For non-listed MISs, the removal and replacement resolutions must be extraordinary resolutions (requiring the approval of at least 50% of the total votes that can be cast by members entitled to vote, whether or not cast).[117]

The *Review of the Managed Investments Act 1998* (2001) (the Turnbull Report) raised the question whether the current requirement for an extraordinary resolution to remove or appoint the RE of an unlisted MIS should be replaced with a simple special resolution (75% of votes cast at a meeting) or, alternatively, a special resolution with the added requirement that votes cast in favour must constitute at least 25% of the total votes of scheme members.[118]

A problem can arise for MIS members who have the necessary votes to pass a resolution removing the RE but have not found an eligible entity prepared at that point to consent to being the new RE. One problem might be that a potential replacement RE has not had sufficient time to conduct due diligence concerning the rights, obligations and liabilities it would inherit by becoming the new RE.[119] The existing RE has no statutory obligation to assist in that due diligence process (a former RE is only required to assist a new RE, not a prospective RE[120]). A potential replacement RE could only

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114 A replacement RE must satisfy the prerequisites of being a public company holding an Australian financial services licence: ss 601FA, 601FK.
115 s 601FM.
116 s 252D.
117 s 601FM and the s 9 definition of 'extraordinary resolution'.
118 rec 2.
119 s 601FS.
120 s 601FR.

apply to the court for access to the books of the MIS if it was a member of the scheme.[121]

In the event that the MIS members pass the removal resolution, but no resolution is passed at the same meeting to appoint a new RE, the legislation states that the scheme must be wound up.[122] There is no express provision for the appointment of a TRE to operate an MIS in these circumstances in lieu of the liquidation of the MIS. A doubt remains whether the provision for an application to the court by a member or ASIC under Corp Reg 5C.2.02 for the appointment of a TRE could be utilised in these circumstances (see *General provision* under Section 4.2.2).

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

> If the investors agree to remove the scheme operator but cannot agree on a replacement operator, the current operator should be obliged to apply to the court for a temporary scheme operator. An investor or the ASC may apply for appointment of a temporary scheme operator if the removed operator does not act.[123]

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?

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

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

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121 s 247A.
122 s 601NE(1)(d).
123 vol 1 para 11.17; vol 2 draft s 183C (p 116).

4.2.4 Related matters

The following matters are also relevant to changing the RE:

- the disincentives to an eligible entity agreeing to act as a TRE, and possible responses to those disincentives (discussed in Sections 4.3 and 4.4)
- the ambit of matters covered by the transfer of rights, obligations and liabilities with a change of RE (discussed in Section 4.5)
- whether some remuneration arrangements for REs may unduly inhibit the capacity to replace an RE (discussed in Section 4.6)
- whether some contractual arrangements between the RE and external parties may unduly the inhibit the capacity of members to replace the RE (discussed in Section 4.7)
- whether provision should be made to permit the appointment of a TRE when an MIS is in voluntary administration (if this procedure is introduced) (discussed in Section 5.5.6).

4.3 Current position of TRE

A TRE has the same general powers to operate an MIS as any other RE would have under the Corporations Act and under the constitution of the MIS.[124] It can exercise the rights of the former RE as operator of the scheme.[125] Its officers and employees are also subject to the various duties pertaining to all REs in administering an MIS.[126]

A statutory role of the TRE is to take the necessary steps to allow the scheme members to appoint a new RE through a members' meeting.[127] Finding a suitable new RE is critical to the continuing operations of an MIS. Having a TRE appointed as an interim measure allows the scheme to continue to operate, while giving some time for an entity that is considering whether to become the

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124 s 601FB.
125 s 601FS.
126 ss 601FC-601FE.
127 s 601FQ.

new RE to carry out due diligence on the commercial and legal implications of that position.

The due diligence to be conducted by a possible new RE would include an assessment of the rights, obligations and liabilities that it would be inheriting (both under transactions of the former RE as operator of the MIS and under the constituent documents of the MIS), as well as an assessment of the property of the MIS against which a new RE could exercise indemnity rights. Gaining a sufficient understanding of the affairs of an MIS for this purpose may be time-consuming where the MIS is large or has been operating for a long time. Reform 1, which seeks to ensure that the transactions on behalf of each MIS can be clearly identified, is intended to assist this process.

Appointment of a TRE is very rare. As previously indicated, the principal reason may be the reluctance of entities to undertake this role without sufficient time to undertake due diligence, particularly in relation to the obligations and liabilities that the RE would inherit. Also, in some circumstances, the transfer of obligations and liabilities may place a TRE at risk of a secured creditor of the former RE appointing a receiver to the assets of the MIS that the TRE now controls, thereby reducing the property of the MIS against which the TRE could claim indemnity rights.

Another consequence of appointing a TRE is that the former RE is permanently relieved of most of its obligations and liabilities in regard to the MIS, notwithstanding that the TRE is only intended to be an interim body to administer the MIS.[128]

4.4 Issues concerning the TRE

The current TRE provisions do not appear to be achieving their original goal of the expeditious appointment of a TRE to operate a commercially viable MIS on an interim basis while a suitable new RE is sought and appointed.

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[128] s 601FS, combined with s 601FJ. The only residual liabilities of the former RE are set out in s 601FS(2)(c) (any liabilities as a member of the MIS) and (2)(d) (any liabilities that the RE incurred for which it could not have been indemnified out of the property of the MIS, usually for the reason that the RE has acted outside its powers as operator of the MIS in incurring the liabilities).

This raises various issues concerning:

- who should be eligible to be a TRE
- what obligations and liabilities of the outgoing RE should the TRE assume (if any)
- the duties of the TRE
- the remuneration of the TRE
- the role of the TRE in relation to the future of the MIS.

4.4.1 Eligibility to be a TRE

Currently, a TRE, like any other RE, must be a public company that holds an Australian financial services licence (AFSL) authorising it to operate this type of MIS.[129]

One view is that this requirement may unduly restrict the classes of persons willing to act as a TRE. One possibility would be to allow registered liquidators, or even any entity or individual, to act as a TRE, if approved by the court.[130] In considering whether to appoint a person that does not hold an AFSL, the court could ensure that the candidate (whether an individual or corporate entity) was suitable for the role of TRE.

A contrary view is that the role of a TRE, like any other RE, is to operate the scheme, albeit on a temporary basis. Arguably, a TRE should have the prerequisite expertise to undertake this task, as well as to fulfil all the other requirements of the AFSL appropriate for the relevant MIS.

Question

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

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129 ss 601FA, 601FK.

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

4.4.2 Outstanding obligations and liabilities of the outgoing RE

Any move to widen the pool of candidates who can be appointed as a TRE does not deal with the apparent central reason for the unwillingness of eligible entities to become a TRE, namely that by accepting that role (and therefore being able to exercise the rights transferred), they become personally liable for most of the obligations and liabilities of the former RE as operator of the scheme.

As stated in *Huntley Management Limited v Timbercorp Securities Limited*:[131]

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

A TRE is a new RE for this purpose.[132]

A clear rationale behind the transfer of financial liabilities and obligations of an RE is to protect scheme creditors, whose claims should not be extinguished or reduced merely because of a change of RE. However, it may also result in a TRE facing losses, particularly if it transpires that its indemnity rights against the assets of the MIS are insufficient to cover the obligations and liabilities that it has inherited.

There can also be considerable uncertainty about what rights and liabilities remain with the former RE,[133] with consequences both for the TRE and external creditors. As observed in *Stacks Managed Investments Ltd*:[134]

> The effect of [ss 601FS(2)(d)] is that the former responsible entity is discharged from its liability to a creditor unless it "could not have been indemnified out of the scheme

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131 [2010] FCA 576 at [69].
132 The s 9 definition of 'responsible entity' makes specific reference to the TRE. See also the reference to TRE in s 601FJ.
133 See s 601FS(2).
134 [2005] NSWSC 753 at [15].

> property if it had remained the scheme's responsible entity". ... the section appears to mean that the creditor will not know whether he should sue the former responsible entity or the new responsible entity for his debt, unless he can determine whether the former responsible entity is entitled to an indemnity. A court will not be able to determine which entity is liable for the debt without resolving the question whether it was properly incurred by the former responsible entity, and the new responsible entity has to make the same assessment.

Given these uncertainties about potential personal liability, an entity may be willing to undertake the role of TRE only if protected from personal exposure to the outstanding obligations and liabilities of the outgoing RE.

Policy options

Any move to review the existing approach to the transfer of liabilities and obligations upon the appointment of a TRE needs to strike a balance between protecting the interests of creditors sufficiently for them to be willing to enter into contracts with an RE in the first place and recognising that, without some protection from personal liability, suitable entities are unlikely to come forward when a TRE is being sought.

The policy options considered below only apply to a TRE. They would not interfere with the current provisions otherwise applicable to a new RE. Where a new RE is appointed (with or without the prior appointment of a TRE), the outstanding obligations and liabilities (including any incurred by a TRE), as well as rights, are transferred to the new RE. This ensures that the appointment of a new RE, including a TRE, does not extinguish the rights of scheme creditors of a continuing scheme. A potential new RE could be assisted by the TRE in undertaking the necessary due diligence.

(i) Election by the TRE

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

A TRE might elect to be bound in one or more instances where it considers that there is sufficient scheme property to cover the obligation or liability and to do so would be in the ongoing interests

of the MIS. Where, for instance, the TRE elects not to be bound by a particular contract of the former RE, the counterparty would still have contractual remedies against the outgoing RE (which would retain its indemnity rights against the property of the MIS).

A possible problem with this option is the time that a TRE may need before it could make an informed election.

(ii) Limited liability of incoming TRE

Another policy option would be to provide that an incoming TRE was liable (with indemnity rights against the MIS assets) only for:

- *liabilities incurred by the TRE*
- *pre-existing MIS liabilities* up to the value of the scheme property available to the TRE after satisfaction of the liabilities incurred by the TRE in its capacity as the TRE of that MIS.

The TRE's indemnity rights in relation to these liabilities would have priority over other claims, including over any indemnity claim by the outgoing RE.

Liabilities incurred by the TRE. The personal liability of the TRE for liabilities that it incurs in that capacity may assist the continuation of the MIS during the interim period by providing comfort to counterparties of the TRE about the payment of their debts.[135] A TRE would have indemnity rights against the scheme assets for such liabilities, in the same manner as all REs. The TRE would itself have to meet any shortfall where the indemnity rights were insufficient to cover the liabilities incurred.

In some instances, a third party may only be prepared to enter into a contract with the TRE if that party's outstanding debts are paid beforehand. If the TRE's indemnity rights are insufficient to cover these outstanding debts, a question arises about the viability of the MIS. This may be an instance where the most appropriate next step is for the MIS to go into external administration (see Chapters 5 and 6).

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

Pre-existing liabilities. The TRE would be personally liable only to the extent that sufficient MIS assets were available to the TRE to cover those liabilities. This would ensure that a TRE would not have to cover a deficiency in assets left by the outgoing RE. Pre-existing creditors would retain the right of recovery against the outgoing RE for any outstanding amounts, with the outgoing RE maintaining its indemnity rights against the property of the MIS.

The residual right of creditors against the outgoing RE would, in effect, mean that this RE could not avoid liability as operator of the scheme (which may be in excess of the funds it could recover from the property of the MIS under its indemnity rights) simply through the appointment of a TRE. It would eliminate any incentive for an RE to seek appointment of a TRE for that purpose.

(iii) Court power

Currently, in appointing a TRE, the court has the power to make any further orders 'that it considers necessary'.[136]

There is uncertainty about the ambit of the court's discretion under this power. On one view, a court may interpret this power more narrowly than, say, its power in corporate voluntary administrations to make such order 'as it thinks appropriate'.[137]

One policy option is to provide the court with a general discretionary power where it appoints a TRE, including to adjust obligations and liabilities between the outgoing RE and the TRE. This would allow the tailoring of these matters to the circumstances of the particular MIS, with a view to giving some protection to scheme creditors while not creating too great a disincentive for any suitable entity to agree to act as a TRE. However, having the court adjust obligations and liabilities may take some time, which might delay the appointment of a TRE.

(iv) Moratorium

A further policy option would be a mandatory moratorium on the enforcement of pre-existing creditors' rights, either during the period

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136 s 601FP(2).
137 s 447A(1).

of a TRE (up to 3 months, unless extended by the court) or some other prescribed or court-determined time.

A moratorium would protect the TRE against the outstanding obligations and liabilities of the former RE. Those obligations and liabilities would remain with the former RE (although frozen during the TRE period), to be transferred to any new RE (replacing the TRE), once appointed.

An argument against this approach is that the ostensible purpose of appointing a TRE is to maintain a viable scheme, which should not need a moratorium (which may also place the solvency of some creditors in jeopardy).

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?

4.4.3 Duties of the TRE

A TRE, its officers and employees have statutory duties in operating the scheme, in the same manner as any other RE and its personnel.[138]

Particularly where the appointment of a TRE is a matter of urgency, it may be difficult for the prospective TRE to determine the implications for it, and its personnel, of the duties it would undertake if it agreed to take on the role of TRE.

What may be required to comply with these duties can be affected by the conduct of the outgoing RE. For instance, an RE and its officers have a duty to maintain and comply with the compliance plan of the MIS.[139] The outgoing RE may have failed in various respects to fulfil this obligation. The TRE may then be faced with the task of implementing steps to ensure compliance with the plan. The same issues may arise with other obligations of an RE, including to ensure that the scheme's constitution meets certain

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138 ss 601FC-601FE.
139 The RE: s 601FC(1)(g), (h). Officers of the RE: s 601FD(1)(f)(iv).

statutory requirements.[140] The magnitude of the task facing the TRE would be in direct proportion to the level of default of the outgoing RE in relation to these matters.[141]

A TRE, like any other corporate trustee, has a duty to operate within its powers. Directors of a TRE will be liable individually and jointly with the TRE for the discharge of any liability incurred by the TRE as trustee of the MIS where the TRE is not entitled to indemnity out of MIS assets because the TRE has committed a breach of trust, has acted outside the scope of its powers as trustee or is denied an indemnity by the terms of the scheme constitution.[142]

A TRE is an interim body appointed by the court to operate an MIS until a replacement RE can be found or the decision is reached to have the MIS placed in external administration. Arguably, it should not be incumbent on a TRE, in that interim period, to undertake a full due diligence of an MIS to discern what needs to be done to ensure full compliance with the statutory duties of an RE and to avoid operating the scheme in a manner that denies the TRE a right of indemnity from scheme assets.

An RE is civilly liable to members for loss or damage that they suffer because of conduct of the RE that contravenes the managed investment provisions.[143] One of the roles of a replacement RE (and its officers), as part of the duty to act in the best interests of members,[144] may be to consider whether an action against the former RE on these grounds is called for. However, it may be unduly burdensome to expect a TRE to review the actions of the former RE for that purpose.

Not all the statutory duties on a TRE may call for adjustment. For instance, a TRE, like any other RE, has a duty to report to ASIC any breach of the Corporations Act that relates to the scheme and that has had, or is likely to have, a materially adverse effect on the interests of members. That reporting obligation arises for an RE 'as

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140 ss 601FC(1)(f), 601FD(1)(f)(iii).
141 See further D Walter, 'Managed investment schemes' (2011) 23(1) *Australian Insolvency Journal* 12.
142 s 197.
143 s 601MA.
144 ss 601FC(1)(c), 601FD(1)(c).

soon as practicable after it becomes aware of the breach'.[145] Arguably, this awareness requirement would not impose a specific obligation on the TRE to review the conduct of the former RE to check for irregularities.

One policy option to avoid the role of a TRE becoming too burdensome would be to give the court the power to adjust the statutory duties of the TRE and its officers and employees, either at the time of appointment of the TRE or at any subsequent time, to take into account the particular circumstances of the MIS. As previously indicated, the court in appointing a TRE has the power to make such further orders as it considers 'necessary'.[146] A question is whether this power would suffice to allow the court to make orders concerning these duties, or whether a more expansive court power to cover these matters would be appropriate.

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?

4.4.4 Remuneration of the TRE

One key consideration for a prospective TRE would be the likelihood of receiving remuneration for its services. An entity may be reluctant to undertake that role unless there is some certainty that adequate funds are available, free of competing claims by other parties.

As previously indicated, in making an order to appoint a TRE, the court has the power to make any further orders 'it considers necessary'.[147]

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

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145 s 601FC(1)(l).
146 s 601FP(2).
147 s 601FP(2).

orders setting out the remuneration arrangements for a TRE, such as a court-determined daily rate.

Question

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

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

Current position

A TRE is intended to be an interim body only. One of its key functions is to take steps for the appointment of a new RE. For this purpose, the TRE is required to call at least one meeting of scheme members to vote on any proposed new RE (if there is an eligible candidate) as soon as practicable and, in any event, within 3 months of becoming the TRE (subject to the court granting an extension of this period).[148]

Where the members' meeting is not held (as there may be no suitable entity willing to become the new RE) or the meeting has not resulted in a new RE being chosen by members, the TRE must apply to the court for the winding up of the MIS.[149] ASIC or any scheme member may make this winding up application if the TRE fails to do so.[150]

A TRE can, like any RE, itself wind up an MIS if it considers that the purpose of the MIS has been, or cannot be, accomplished, subject to any contrary view of scheme members at a meeting to consider the proposed winding up.[151] In addition, a TRE may at any time apply to the court for the winding up of the MIS on the 'just and equitable' ground.[152]

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148 s 601FQ(1).
149 s 601FQ(5).
150 s 601FQ(5).
151 s 601NC.
152 s 601ND(1)(a), (2)(a).

Conflict of interest

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

As previously indicated, the decision on the appointment of a new RE rests with the scheme members. There is specific statutory recognition of the right of members to appoint the TRE as the new RE if the TRE is willing.[153] However, given the central role of the TRE in the process for appointing a new RE, there is the potential for a conflict of interest between the desire of the TRE to be elected as the new RE and its role in seeking expressions of interest from other parties who may, in effect, compete with the TRE for the position of new RE.

MIS administrator proposals

The proposals discussed in Chapter 5 to introduce procedures for the voluntary administration of an MIS also have implications for the TRE of an MIS that, as it turns out, is under financial stress but is potentially viable:

- should the TRE have a role in the appointment of an MIS administrator
- if, so, should the TRE be able to make that appointment on its own initiative, or only have the right to make application to the court for such an appointment
- if the TRE has a unilateral right to appoint an MIS administrator:
  - should the exercise of that power be subject to some legislative constraints, for instance that the TRE 'thinks that the MIS is insolvent, or is likely to become insolvent at some future time'[154]
  - should there be a prohibition on the TRE appointing itself as an MIS administrator (assuming it is eligible to so act) without creditor or court approval?[155]

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153 s 601FQ(3).
154 cf s 436B(1) for companies.
155 cf s 436B(2) for companies.

Assistance to an external administrator

In the event of an external administrator being appointed to the MIS, the appointee will most likely seek assistance from officers and employees of the TRE, as well as requesting the TRE to provide access to information and documents relevant to the MIS.

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

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?

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

Reference has already been made to the need for any entity considering becoming a new RE to take into account the consequences of ss 601FS and 601FT regarding the transfer of rights, obligations and liabilities that accompany any change of RE.

In some instances, what is transferred pursuant to those provisions can become a matter of uncertainty or dispute. The courts have considered the ambit of these sections on a number of occasions.

In one case, the Court considered whether these sections, combined with the provision stating that '(t)he responsible entity holds scheme property on trust for scheme members',[156] caused incoming responsible entities to 'acquire property that is subject to a charge'.[157] The Court observed that:

> Sections 601FS(1) and 601FT(1) are drafted in a particularly economical way. They appear intended to cause an incoming responsible entity to step into the shoes of its predecessor ... . Yet nowhere does one find in those two sections any reference to property. There is a reference to "rights", being rights "in relation to the scheme", and there can be no doubt that certain "rights" (although not all) are property. The sections do not seem to effect a form of statutory vesting or assignment of property generally in such a way that the incoming responsible entity "acquires property that is subject to a charge" (as mentioned in s 264) except, perhaps, to the extent that the subject matter of the charge is a species of property which clearly involves no more than a "right". An example might be the kind of property involved in a charge made registrable by s 262(1)(f) referring to "a charge on a book debt". A debt as a chose in action falls quite comfortably within the concept of "right". But even then, there is a question whether a chose in action forming part of the assets of a scheme is a right "in relation to the scheme". These last words are perhaps intended to cover only rights vis à vis parties such as members of the scheme, being rights arising from or forming part of the matrix of legal relationships making up the scheme, including rights derived from the scheme's constitutional documents.[158]

In a subsequent decision,[159] the Court made a number of general observations about the ambit of ss 601FS and 601FT:

> It is vital that the words "rights, obligations and liabilities" in Div 3 of Pt 5C.2 be given a broad construction so as to achieve the evident legislative purpose of facilitating an immediate and seamless change of the responsible entity of a

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156 s 601FC(2).
157 s 264(1).
158 *Investa Properties Ltd* [2001] NSWSC 1089 at [11].
159 *Huntley Management Ltd v Timbercorp Securities Ltd* [2010] FCA 576 at [45]-[50]. See also *Syncap Management (Rural) Australia Ltd v Lyford* [2004] FCA 1352 at [41] ff, and *Primary RE Limited v Great Southern Property Holdings Limited (recs & mgrs apptd) (in liq)* [2011] VSC 242 at [166] ff.

scheme whenever ASIC records the new entity's name in its record of a registered scheme.

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

I reject that argument. The expression "in relation to" is of wide and general import and should not be read down in the absence of some compelling reason to do so: *Fountain v Alexander* [1982] HCA 16; (1982) 150 CLR 615 at 629 per Mason J. In *Syncap Management (Rural) Australia Ltd v Lyford* [2004] FCA 1352; (2004) 51 ACSR 223 at [46] RD Nicholson J held that "in relation to" as used in s 601FS(1) was an expression of wide import and signified no more than some relationship or connection. As Lindgren J noted, however, the rights, obligations and liabilities of the former responsible entity to which each of ss 601FS(1) and 601FT(1) apply, are impliedly limited to those capable of having an ongoing operation after the change in responsible entity: *Re Huntley Management Ltd; Australian Olive Holdings Pty Ltd v Huntley Management Ltd* (2009) 76 ACSR 256 at [85].

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

I am of opinion that ss 601FS(1) and 601FT(1) create a means of ensuring that rights to hold, and rights "in relation to", scheme property pass to and vest in the new responsible entity. This is because ss 601FJ, 601FS(1) and 601FT(1) cause all rights of the former responsible entity "in relation to the scheme" to pass to the new one once changed: cf *City Pacific Ltd (in liq) v Ballandean Investments Pty Ltd* [2010] QCA 113 at [23], [26], per Holmes JA with whom McMurdo P and Chesterman JA agreed and *Capelli v Shepard* [2010] VSCA 2; 264 ALR 167 at [143], [148] per Dodds-Streeton and Mandie JJA and Byrne AJA; *Treecorp*

> *Australia Ltd (in liq) v Dwyer* [2009] FCA 278; (2009) 175 FCR 373 at [46], [48] per Gordon J. Likewise, those sections novate obligations and liabilities of the former responsible entity "in relation to scheme property" in the new responsible entity. The language of those provisions suggests that the Parliament had novation, not merely assignment, in mind: *Olsson v Dyson* [1969] HCA 3; (1969) 120 CLR 365 at 388-391 per Windeyer J especially at 388; see too *Goodridge v Macquarie Bank Ltd* [2010] FCA 67; (2010) 265 ALR 170 at [106]-[114] where I discussed the distinction between novation and assignment in contract.
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> Here, the statutory scheme in Div 3 of Ch 5C.2 is clearly intended to apply to a change of, and effect a transfer between, responsible entities in all situations so as to ensure that the incoming one has the fullest and most effective control of the whole of the scheme and scheme property at the instant that s 601FJ gives effect to the change. This will be achieved by giving a purposive and broad construction to the expression "in relation to the scheme" in applying ss 601FS and 601FT.

Another case queried the extent to which rights under a validly terminated agreement are transferred to a new RE.[160]

Question

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

4.6 Remuneration where RE replaced

The chances of attracting a new RE to operate a viable MIS (whether or not a TRE is appointed as an interim measure) can be affected by the remuneration arrangements for any replacement RE.

The scheme constitution must set out the rights of the RE to be paid fees out of scheme property.[161] The legislation preserves to a former RE any rights to be paid fees for the performance of its functions

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

161 s 601GA(2).

before it ceased to be the RE.[162] However, the legislation does not deal with the respective rights of the former and new RE where there is a transfer of responsibilities during a financial period.

In *Huntley Management Limited v Australian Olives Limited*,[163] an RE was replaced during the course of a financial year. The new RE claimed an entitlement to be paid on a pro rata basis for that part of the annual management fees for the financial year that was referable to the period that it operated the scheme during that year. The former RE, which had been paid the entire management fees for the financial year at the commencement of that year, claimed to be entitled to retain all those fees under the terms of the constitution of that scheme. The Full Federal Court determined that under the relevant terms of the constitution of the MIS:

> a debt in favour of [the former RE] for the whole of the management fee payable by the investors in those projects in respect of each year comes into existence at the beginning of each year. ... Once the annual amount was paid, the investors' debts to [the former RE] as the responsible entity of Projects 1 and 2 were discharged. There was nothing to which [the new RE] could accede upon its appointment as the new responsible entity for those projects.[164]

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

Likewise, in *Saker, in the matter of Great Southern Managers Australia Ltd (Receivers and Managers Appointed) (in liquidation)*,[165] the relative rights of the former RE and the replacement RE to certain funds turned on the terms of the constitution of the MIS, which provided the former RE with priority rights.

As observed by one commentator:

> There is a real risk that, if the constitution [of an MIS] is in similar terms to those of the projects considered in *Huntley*

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162 s 601FS(2)(a).
163 [2010] FCAFC 98.
164 at [24].
165 [2010] FCA 1080.

> *Management*, management fees will not be able to be received until the next annual payment period arrives.

and:

> *Great Southern Managers* and *Huntley Management* both make it clear that it is permissible for incumbent responsible entities to receive and retain substantial benefits out of 'scheme property' even after their removal.[166]

It is arguable that leaving all matters concerning the remuneration of the RE to the terms of a scheme's constitution provides an opportunity for an RE that has been replaced to receive unearned benefits. It may also make it practically impossible for members of a viable RE to attract a replacement RE, where the fee relating to a significant period of time has already been paid to the former RE.

The Turnbull Report recommended that the Corporations Act should ensure that payment of fees or a right to an indemnity cannot be claimed in advance of an RE's proper performance of its duties.[167]

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?

4.7 Arrangements between an RE and external parties

Some arrangements between an RE and an external party may, in effect, inhibit the capacity of MIS members to change the RE. For instance, an RE may enter into a contractual arrangement whereby the counterparty will provide debt facilities to it in relation to a particular MIS, on condition that the RE does not change or any change is approved in advance by the counterparty.

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

167 rec 6.

The consequence of entering into such a debt covenant may be that, while MIS members are legally entitled to change the RE, the result may be that the debt facility is withdrawn and the loan becomes immediately repayable.

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?

5 Restructuring a potentially viable MIS

This chapter discusses the question in the terms of reference whether REs are unable to restructure a financially viable MIS and whether the current legislative methods available to companies under the Corporations Act should be adapted to MISs. It discusses a possible procedure, based on corporate voluntary administration, to permit a financially stressed but potentially viable MIS to continue to operate rather than be wound up.

5.1 Context

The previous chapter deals with the process for replacing the RE of a viable MIS.

This chapter deals with the situation where an MIS is in financial stress but could possibly be restored to financial viability. It considers:

- the circumstances in which the RE of the MIS could achieve this goal
- the circumstances in which this goal might be achieved by the introduction into the MIS provisions of a voluntary administration (VA) procedure for schemes, based on the approach in Part 5.3A of the Corporations Act.

The principal purpose of a corporate VA under Part 5.3A is to impose a general moratorium on the rights of creditors, pending an opportunity for them to consider whether to enter into some form of compromise or other arrangement, binding consenting secured and all unsecured creditors and the company. Such arrangements are usually designed to permit the company to continue as a going concern or to provide for a better return to creditors than if the company was immediately wound up.[168]

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[168] The objects of voluntary administration are set out in s 435A.

The VA provisions presently only apply to companies. An RE, being a company, can be placed in VA. However, an MIS, not being a company, cannot be placed in VA.

5.2 Current position

5.2.1 Concept of an MIS in financial stress

An MIS is not a separate legal entity. It is operated by the RE of the scheme, which enters into binding arrangements with creditors in its personal capacity, but with indemnity rights against scheme property in regard to those arrangements.

A trust-based MIS may involve the pooling of members' funds, with the pooled funds constituting the scheme property for the RE to invest or otherwise utilise according to the terms of the scheme constitution. Such an MIS may be described as being in financial stress when it has insufficient scheme property to meet, now or at some future time, the lawful indemnity and remuneration claims of its RE in operating the MIS.

A contract-based scheme may involve members contributing to a common enterprise to be operated by the RE. The scheme may principally involve a series of contractual and proprietary arrangements between the RE, scheme members and third parties, from which profits are to be generated from the common enterprise and distributed according to agreed terms. There may be little in the way of scheme property.

Sections 5.3-5.5 consider a possible VA procedure for an MIS in financial stress. This raises the initial question of how to assess financial stress of an MIS for this purpose (see further Section 5.4.2).

The financial stress of an MIS (however defined) may or may not affect the solvency of its RE and the capacity of the RE to restructure a potentially viable MIS. There are several situations to consider, only some of which may call for consideration of legislative initiatives to assist the MIS rehabilitation process.

5.2.2 Sole function RE

The least complex situation involves a sole function RE. Apart from any available capital of its own, the RE may be dependent upon its indemnity rights and remuneration claims against the property of the MIS as its sole or principal source of funds to remain solvent itself. The financial viability of the sole function RE and that of the MIS are therefore directly interlinked.

Where such an MIS is in financial stress, its sole function RE might seek to enter into an informal 'workout' or other compromise or arrangement with some or all of its creditors to permit it, and its MIS, to continue to function. Creditors might agree to compromise or postpone their claims in anticipation of a future return to profitability of the MIS, or at least a better return to them than if the RE immediately went into external administration and the MIS was wound up. However, these informal arrangements are not binding on any non-participating creditors.

In the absence of an informal arrangement of this nature, the RE may seek to achieve a compromise with creditors by going into VA or may go into liquidation. The 'affairs' of the RE, for the purpose of either form of external administration, would cover the operations of the MIS.[169] The VA or liquidation of a sole purpose RE would therefore also determine the future of its MIS.

5.2.3 Multi-function RE

The processes for dealing with the possible rehabilitation of a financially stressed MIS may become more complex where its RE is a multi-function RE.

Solvent multi-function RE

A multi-function RE of a financially stressed MIS may itself be solvent (in consequence of its other operations) and may continue to meet from its own funds the claims of creditors with whom it has

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[169] The definition of 'affairs' in s 53 includes its affairs as 'trustee'.

contracted as operator of that MIS.[170] The RE may also choose not to exercise all or some of its indemnity/remuneration rights against the property of the MIS, for some time at least, whilst seeking to restore the scheme to financial viability. This may involve the RE selling some of the assets of the MIS or otherwise restructuring its operations.[171]

At some stage in this process, the RE may decide to 'cut its losses' by taking steps to wind up the MIS on the basis that the purpose of the scheme cannot be accomplished.[172] Scheme members have rights to be informed and to meet to consider the winding up proposal.[173] Members may seek to have a replacement RE appointed if a suitable entity is willing to undertake that role.[174] The RE would be entitled to exercise against scheme property any outstanding indemnity rights or remuneration claims not forgone if the MIS is liquidated or a new RE is appointed.

Another possibility is that creditors may be willing to enter into a compromise of their existing claims, notwithstanding that the RE is still solvent and could meet those claims, if it is in their interests for the business of the MIS to continue as a going concern, rather than be liquidated by the RE. Some creditors may have long-term commercial arrangements that are dependent on the continuing operation of the MIS. In those circumstances, creditors may benefit from an external administration procedure for the MIS by which they could enter into a deed that binds all creditors and by which the RE would agree not to wind up the MIS.

Insolvent multi-function RE

The most difficult problems in practice in attempting the rehabilitation of a financially stressed but potentially viable MIS can

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170 The RE may do so to avoid unsatisfied creditors seeking to have the RE wound up, given that they contract with the RE, not the MIS. Any such payments by the RE must be lawful. It would be a breach of duty, for instance, for an RE to use the property of one MIS it operates to pay debts that the RE has incurred in operating another MIS, unless expressly permitted by the constitution of the former MIS.

171 In selling assets of the MIS or otherwise restructuring its operations, the RE and its officers must comply with their statutory duties (ss 601FC, 601FD) and any relevant terms of the scheme constitution (s 601GA). Section 601GC sets out the procedures for changing the constitution.

172 s 601NC(1).

173 s 601NC(2).

174 s 601FM.

arise where the MIS is operated by a multi-function RE, which itself goes into external administration. The precipitating cause or causes may be the financial stress of that MIS and/or other MISs that the RE operates, losses incurred by the RE in activities unrelated to the operation of its MISs, or some combination of these events.

Where the RE goes into external administration, its 'affairs' for the purpose of that administration, in principle, include the operations of all the MISs that the RE controls (as well as any other business dealings of the RE). However, seeking to deal with the affairs of a particular MIS through a VA for an insolvent multi-function RE may be unsatisfactory or impractical, as:

- it may be unworkable, unduly complex or very time-consuming to devise for an RE a deed of company arrangement that satisfactorily deals with the particular circumstances of each of the MISs that the RE controls, taking into account the possible differences in the level of actual or potential financial viability of different MISs

- it may be anomalous for certain of an RE's creditors to vote on that part of a proposed deed of company arrangement that deals with a particular MIS in which those creditors have no direct financial interest. The VA provisions do not allow for separate votes of different classes of creditors with different types of interests or for the directors of the RE to appoint an administrator over that part of its affairs that relates to a particular MIS, with only the creditors of that MIS having voting rights[175]

- a voluntary administrator of the RE may not have an automatic right to draw on property of an MIS to pay its costs for any work it may do in investigating the affairs of that scheme, given that the administrator's appointment is to the RE, not to the MIS, and the RE holds scheme property on trust for MIS members.

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[175] For instance, creditors in the VA of an RE may include creditors whose claims relate to the operation by the RE of a particular MIS as well as creditors of the RE whose claims relate to other activities of the RE (including other MISs operated by the RE). All creditors of the RE would vote as one class on any proposed deed of company arrangement.

Given these considerations, the question arises whether, in some instances at least, the restoration of a financially stressed but potentially viable MIS might be better achieved if a VA procedure specifically designed for MISs is introduced.

5.2.4 Property problems arising with some MIS arrangements

Some of the difficulties experienced in recent years in dealing with MISs in financial stress have arisen from disputes concerning the rights of various parties over property used in connection with the operations of some MISs.

In trust-based MISs, scheme members usually have no legal interest in any property used in connection with the scheme. However, the arrangements in some contract-based MISs may involve members holding proprietary or contractual interests in property used in connection with the scheme.[176] Also, third parties may have legal rights over those interests.[177]

Members and third parties may seek to assert these interests when an MIS experiences financial stress. In some instances, MIS members have sought to assert claims over property connected with an MIS that is involved in an external administration, arguing that the property in question is not scheme property.

Some proprietary claims can be dealt with without court application.[178] However, 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.

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176 For instance, some MISs, particularly in the agribusiness sector, involved the scheme members having a form of property interest in 'allotments' of land used for the particular agricultural purposes of the scheme, with the investors having certain property or contractual rights to the products of that land (for instance, trees or crops). Proceeds from the sale of products, after deduction of costs and fees charged by scheme operators, were pooled and distributed to investors in proportion to the number of allotments of land they held.

177 For instance, property owned by an MIS member and not forming property of the MIS could be provided as security for some aspect of the operations of the MIS, with the consent of the member.

178 For instance, members' contractual or other property rights can be removed if permitted by the scheme constitution, typically for failure to pay contributions.

There is some possibility, as part of restructuring an MIS, of amending agreements concerning the proprietary rights of members without the need to obtain the separate consent of each affected member. However, this possibility would depend on the precise terms of the documentation for a particular scheme.[179] Beyond that, the proprietary claims of members and the claims of relevant third parties are largely outside any compulsory procedure concerning the external administration of an MIS.

5.3 The concept of an MIS voluntary administration

The overall purpose of the VA procedure for a company under Part 5.3A of the Corporations Act is to impose a moratorium on any actions or proceedings concerning the company to allow an opportunity for an independent party (the administrator) to assess the potential viability of the company, with a view to advising creditors whether it would be in their interests:

- to enter into a deed of company arrangement (DOCA) that would allow the company to continue to operate, rather than be wound up
- to have the company wound up
- for the administration to end, with the company continuing as before.

A similar process could be adopted for the VA of an MIS.

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[179] In *Great Southern Managers Australia Limited (Receivers and Managers appointed) (in liq)* [2009] VSC 557, the Court considered that it was reasonable to call meetings of members of the MIS to consider and vote on resolutions intended to effect changes to growers' agreements without the need to obtain the separate agreement of each grower. The Court's view depended on the terms of the documentation involved, including a power of attorney granted by the growers when they signed the application form for an interest in the MIS. Even the power of attorney would not be sufficient to support the required changes if the MIS member who granted the power had died or revoked the power (at [13]). The Court also acknowledged arguments that the use of the power of attorney for this purpose may not have the desired result, but considered that 'it is by no means clear that such arguments must succeed' (at [18]).

The ALRC/CASAC report contained detailed recommended procedures for conducting the VA of an MIS.[180]

The procedure in that report focused on MIS creditors. However, as indicated above (Section 5.2.4), various MISs in more recent times have involved members or third parties with proprietary or contractual interests in property used in connection with the operations of the MIS. This development may indicate a need for the VA of an MIS to extend beyond creditors of the MIS to take into account this broader range of parties that may be involved in the affairs of an MIS. In this way, a potentially viable MIS can be stabilised, at least temporarily, so that the likelihood of its rehabilitation can be determined.

5.4 Elements of a VA for an MIS

5.4.1 Ambit of the VA of an MIS

In a corporate VA, the only involved parties are the creditors of the company. Shareholders or other affected third parties have no right to be consulted or to vote on a DOCA.

A VA procedure for a potentially viable MIS may need to apply to a broader range of parties (as mentioned in Section 5.3 and set out in Section 5.4.4), and encompass a broader range of transactions involving those parties, than would be the case in a corporate VA. An example of the types of transactions that might need to be included for the VA of an MIS to be effective would be member transactions (as described in Section 3.6).

The need for this broader concept of what interests might need to be included in the external administration of an MIS has been recognised by the courts. For instance, in one case, the Court defined the concept of a scheme in broad terms for the purpose of determining whether it was insolvent:

> Insofar as the scheme is characterised as no more than a trust fund or "scheme property" held on trust for scheme

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[180] vol 1, para 8.13 (rec 65, p xxix), vol 2, pp 176-214 (proposed 'Part 5.3B—Administration of the affairs of a collective investment scheme with a view to executing a deed of arrangement').

> members by the responsible entity, the condition of insolvency may not easily attach. But in my view the scheme is something more than trust assets or scheme property.
>
> By adopting a more generous definition of a scheme, by reference to the scheme documents, relationships, objectives, inputs and outcomes, the concept of insolvency may be applied without much difficulty if the scheme has broken down because the responsible entity has no funds to continue the management and administration of the scheme and no reasonable prospect of getting in those funds.[181]

The experience of some recent MIS failures points to the need to embrace a wider notion of what matters should be included in the voluntary administration of an MIS, to avoid attempts at rehabilitation being frustrated by individuals seeking to assert claims outside this process.

5.4.2 Commencement of an MIS administration

Grounds for initiating the VA of an MIS

The usual test for determining whether a company is in financial stress for the purpose of placing it in VA is that certain persons have formed the opinion that the company 'is insolvent or is likely to become insolvent at some future time'.[182]

The question arises whether a comparable insolvency test would be appropriate for some, or all, MISs, taking into account the structural differences between MISs, including between trust-based and contract-based schemes.

Who can place an MIS into VA

The board of directors or the liquidator of a company, and in some instances a substantial chargee, may appoint an administrator to the company.[183] Entry of a company into VA does not require court approval.

A VA of an MIS could, at least during the moratorium period, affect a broader range of parties that a corporate VA. The proposed VA

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181 *Re Environinvest Ltd* [2009] VSC 33 at [104]-[105].
182 ss 436A, 436B.
183 ss 436A, 436B, 436C.

procedure for MISs would extend beyond creditors to include members in regard to any property and contractual rights that they may have in regard to the operation of the scheme, as well as third parties with related rights. A wider moratorium may also protect members' proprietary interests from the actions of third parties (for instance, by preventing a head lessor from terminating its leases with MIS members on the external administration of the RE).

The legislative options could be to:

- stipulate particular persons who may appoint an MIS administrator on their own initiative, and/or
- provide that the court may make this appointment, upon application by stipulated persons.

In the latter case, a possible prerequisite for the court's exercise of its power could be that it considers that the relevant grounds for initiating the VA have been satisfied and that a VA would be in the general interests of the creditors and members of the MIS and would not be unduly detrimental to affected third parties.

5.4.3 Effect of the appointment on the RE

The MIS administrator would replace the RE as operator of the MIS. However, the RE, even if under external administration, would remain in office (as every MIS must have an RE), but without powers to operate the MIS during the VA.[184] In consequence, the administrator's appointment would not activate the transfer of rights, obligations and liabilities that accompanies the replacement of an RE.[185] The potential liabilities of an MIS administrator in operating the scheme are discussed at Section 5.5.3.

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184 cf s 437C, which suspends the powers of directors and other corporate officers during the period that a company is in voluntary administration. Also, during that period, only the administrator can deal with the company's property: s 437D. The ALRC/CASAC report recommended similar provisions for the VA of an MIS: vol 2, draft ss 458CC, 458CD (pp 179-180).

185 Stated another way, the appointment of an administrator would not constitute a change of RE for the purposes of s 601FS.

5.4.4 Moratorium

The appointment of an administrator would initiate a moratorium. The moratorium could freeze any actions, proceedings or assertions of rights concerning the affairs of the MIS, including against the RE in its capacity as operator of the MIS, by the following classes of persons:

- *MIS creditors:* creditors of the RE in its capacity as operator of the MIS,[186] subject to the right of substantial chargees to enforce their rights within a specified time of being notified of the appointment of an MIS administrator[187]

- *members as holders of proprietary or contractual rights:* members of the MIS in relation to any proprietary or contractual rights, obligations or liabilities that they have incurred and that relate to the operation of the MIS. These types of transactions are further discussed in Section 3.6

- *third parties:* third parties in relation to any interest that they may have in the subject matter of the MIS or any claim that they may have against:

  - the RE in its capacity as operator of the MIS

  - scheme members in that capacity, or

  - property that is or might be scheme property

- *members in their capacity as members:* members of the MIS in relation to any voting, redemption or other rights given to them in the legislation or pursuant to constituent documents of the MIS.

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186 See Reform 4 in Chapter 3.

187 Property of an MIS may be used as security for funding to support the operations of the scheme, with, for instance, the chargee having the right to appoint a receiver to the property in the event of default. The ALRC/CASAC approach envisaged the MIS administrator being required to notify his or her appointment to any substantial chargee of scheme property: vol 2, draft s 458RA(3), (4) (p 211) (cf s 450A(3), (4) for companies). Upon notification, the chargee would be permitted to enforce the charge, either itself or through a receiver or other agent, within a specified time: vol 2, draft s 458GA (pp 188-189) (cf s 441A, s 9 definition of 'decision period' for companies).

The moratorium could operate for a stipulated period (subject to extensions being granted by the court[188]) to provide an opportunity for the MIS administrator to investigate the affairs of the MIS and to prepare proposals for consideration by creditors, third parties and members, where appropriate.

5.4.5 MIS deed

The MIS administrator's proposals may include a draft MIS deed. Depending on the circumstances, the draft deed may provide for postponement or compromise of the proprietary or contractual rights of members of the MIS or the related rights of third parties. It may also provide for a compromise of distribution or other rights that members may have as contributors to the scheme.

Approval by a stipulated majority of an affected class would bind the minority of that class to the MIS deed.[189] Affected parties would have the right to challenge an MIS deed on the ground that it is unfairly prejudicial to, or discriminatory against, them.[190]

5.4.6 Winding up or end of administration

In some circumstances, an MIS administrator may propose that the MIS be wound up or that the administration end without any other action such as entry into an MIS deed.

5.4.7 New RE

Implementation of an MIS deed may require finding a willing and suitable new RE to operate the MIS.

Questions

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

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

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188 Cf s 439A(5), (6) for companies.

189 Cf a corporate VA, where a resolution of creditors requires the support of a majority by number, as well as by value, of creditors: Corp Reg 5.6.21(2), (3).

190 cf s 445D(1)(f)(i) for companies. See also s 600A for the court's power where the outcome of a vote has been determined by a related entity.

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

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

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

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
  - where classes vote on the deed, should they be entitled to vote on the whole deed or only that part that affects their interests
  - should the approval of all voting classes be required for the MIS deed to come into force, or should the deed apply to those classes that have approved it
- 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?

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?

A range of other issues concerning the VA of an MIS is discussed in Section 5.5, below.

5.5 Other matters relevant to the VA of an MIS

5.5.1 Avoiding duplicate VAs

As previously indicated (Section 5.2.2, 5.2.3), where an RE is in external administration, its affairs include the conduct of any MIS that it operates.

To avoid duplication or overlap of voluntary administration procedures, it may be necessary to provide by legislation that, where an MIS goes into VA, all scheme property and all claims by MIS

creditors should be dealt with only under the VA of the MIS. The other classes of persons that may be involved in the VA of an MIS (see Section 5.4) would not be covered by the VA of an RE.

There could also be a requirement that any information that is obtained by an external administrator of the RE and that is relevant to the VA of the MIS be provided to the MIS administrator.

Question

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

5.5.2 Who can be an MIS administrator

Only a registered liquidator can be the administrator of a company or of a deed of company arrangement.[191]

One possibility is to give the court the power to appoint any person it considers suitable to conduct the VA of an MIS, whether or not that person is a registered liquidator or would be eligible to be the RE of the scheme.[192] This wider category of potential administrators may assist in ensuring that an MIS administrator has any specialist skills needed to conduct the administration of a particular MIS.

A contrary view is that such a court power is unnecessary. In practice, administrators of insolvent companies employ persons with specialist skills to operate the company, or some aspect of it, where necessary.[193] The same approach could be adopted by an MIS administrator.

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191 s 448B.

192 Section 601FA provides that the RE must be a public company holding an Australian financial services licence.

193 For instance, Principle 13 of the IPA *Code of Professional Practice for Insolvency Practitioners* states: 'When accepting an appointment the Practitioner must ensure that their firm has adequate expertise and resources for the type and size of the Administration, or the capacity to call in that expertise and those resources as needed.'

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?

5.5.3 Powers and liabilities of the MIS administrator

The willingness of suitable persons to accept the role of MIS administrator may depend in large measure on the powers that they can exercise, and the level of liability to which they are exposed, in that role.

The administrator of a company has control of the company's business, property and affairs and has a range of statutory powers, including:

- to carry on that business and manage that property and those affairs
- to terminate or dispose of all or part of that business
- to dispose of any of that property
- to perform any function, and exercise any power, that the company or any of its officers could perform or exercise if the company were not under administration.[194]

The ALRC/CASAC report proposed that an MIS administrator have similar powers.[195]

The ALRC/CASAC approach also proposed that an MIS administrator, in the exercise of those powers, would only be liable for contractual or other liabilities that the administrator incurs while acting in that role. That would cover, for instance, services rendered to the administrator, goods bought or property hired, leased, used or occupied by the administrator or for rental payments for property

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194 s 437A.
195 vol 2, draft s 458CA (p 179).

that the administrator intends to continue using.[196] This personal liability of the MIS administrator would protect the interests of the counterparty to any transaction with the MIS administrator and in this way help maintain the operations of the MIS during the administration period.

The ALRC/CASAC approach envisaged the administrator having an indemnity out of the scheme property for the debts he or she lawfully incurred in that role.[197] That indemnity right would take priority over any indemnity rights of the RE over that property.[198]

Questions

Should an MIS administrator have similar powers to those of 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?

5.5.4 Remuneration of the MIS administrator

Under the corporate VA provisions, the remuneration of a company administrator is determined:

- by agreement between the administrator and the committee of creditors (if any); or
- by resolution of the company's creditors; or
- if there is no such agreement or resolution—by the court.[199]

A similar procedure applies to the determination of the remuneration of a deed administrator.[200]

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196 vol 2, draft ss 458JA, 458JB, 458JC (pp 194-195) (cf ss 443A, 443B, 443BA, 443C for companies).
197 vol 2, draft s 458JD (p 196) (cf s 443D for companies).
198 vol 2, draft s 458JE (pp 196-197) (cf s 443E for companies).
199 s 449E(1). This section incorporates reforms recommended by CAMAC: *Corporate Voluntary Administration* (1998) rec 38, *Rehabilitating large and complex enterprises in financial difficulties* (2004) rec 18.
200 s 449E(1A).

The remuneration of administrators and deed administrators has priority in a corporate winding up.[201]

On one view, the legislation could provide a similar procedure for determining the remuneration of an MIS administrator and an MIS deed administrator, with comparable provisions for the priority that this remuneration has on winding up.

Questions

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

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

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?

5.5.5 Court powers

The ALRC/CASAC approach envisaged the court having the power, similar to its general discretionary power under s 447A in a corporate VA, to make such orders as it thinks appropriate about how the MIS administrator provisions are to operate in relation to a particular MIS, on application by:

- the RE
- a creditor of the RE
- the MIS administrator
- the deed administrator
- ASIC
- any other interested person.[202]

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[201] s 556. The winding up priority provisions also apply to payments under a deed of company arrangement, unless the deed provides expressly to the contrary s 444A(5), Corp Reg 5.3A.06, Schedule 8A cl 4.

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?

5.5.6 Need for an ongoing RE

The purpose of a VA procedure is to assist the financial rehabilitation of an MIS, where possible. The ALRC/CASAC approach envisaged that, during the period of the VA, the former RE would remain in that role (as every MIS requires an RE), though without any powers to operate the scheme. The future of an MIS would therefore depend not only on the outcome of the VA process but also on the willingness and ability of the existing RE to continue in that role, or of another party to accept appointment as a replacement RE.

Any entity considering taking on the role of replacement RE would need to undertake due diligence to evaluate the financial and commercial circumstances and prospects of the MIS, given that a replacement RE is subject to the obligations and liabilities, as well as inheriting the rights, of the outgoing RE.[203] The terms of an MIS deed may suffice to attract a new RE by reducing these obligations and liabilities to manageable proportions. Also, the administrator of the MIS could assist a potential new RE to conduct the necessary due diligence.

Where an MIS deed has been accepted, but the existing RE is no longer able to perform that role[204] and no other party is willing to become the RE, the MIS would need to be wound up. One possibility, where greater time may be necessary to attract a suitable new RE, would be to confer on an MIS administrator or the court a power to appoint a TRE to operate the scheme, for some time at

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202 vol 2, draft s 458NA (pp 204-205) (cf s 447A for companies). G Bigmore & N Hannan, 'Issues arising out of winding up managed investment schemes' (2010) 11(3) *Insolvency Law Bulletin* 42 at 44 consider that the introduction of the equivalent of s 447A would assist in taking account of the diversity of industries in which MISs operate.

203 s 601FS.

204 For instance, one effect of an RE going into insolvency is that it may lose its Australian financial services licence, which is a prerequisite to being an RE: s 601FA.

least. Any TRE would be in the same position in regard to obligations, liabilities, duties etc as a TRE appointed to a viable scheme (Section 4.4).

Question

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?

6 Winding up a non-viable MIS

This chapter considers the questions in the terms of reference whether the current statutory framework is adequate for the winding up of MISs, whether that framework provides the necessary guidance for liquidators, creditors, investors and growers, and whether legislative amendments should be made if the current legislative framework does not provide the necessary legislative tools with respect to the arrangements for dealing with non-viable MISs.

6.1 Overview of the winding up provisions

Chapter 5C.9 of the Corporations Act sets out various grounds for winding up an MIS and the steps for initiating that process.

These grounds cover a number of circumstances where an MIS may be wound up, including where it is no longer viable.

6.1.1 Initiating a winding up without the need for court application

Constitution

The constitution of an MIS may set out circumstances where the scheme is to be wound up (at a specified time, in specified circumstances or on the happening of a specified event), though any attempt in the constitution to entrench a particular RE by requiring that the MIS be wound up if that entity ceases to be the RE is of no effect.[205]

Members

The members of an MIS may, at any time, by extraordinary resolution (being at least 50% of the total votes that may be cast by members entitled to vote on the resolution, whether or not cast)

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[205] s 601NA.

direct the RE to wind up the scheme.[206] The meeting can be called by at least 100 members entitled to vote or members with at least 5% of the total votes.[207]

The RE

An RE may initiate the winding up of an MIS where it considers that the purpose of the MIS has been accomplished or cannot be accomplished.[208] On one view, an RE could use this ground to wind up an MIS that was no longer financially viable.[209]

The RE must first give notice of its intention to the MIS members and ASIC, with:

- an explanation of the proposal to wind up the scheme (including how the purpose of the scheme has been accomplished or cannot be accomplished)
- an indication to members of their right to call a meeting of members on this proposal
- a statement that the RE is permitted to wind up the scheme if a meeting of members is not called within 28 days.[210]

The onus is placed on members to request the meeting.[211] If members call a meeting, they may pass an extraordinary resolution[212] concerning the proposed winding up. Subject to any such resolution, the RE is entitled to proceed with the winding up.

Also, the RE of an MIS 'must ensure that the scheme is wound up' if the members pass a resolution removing the RE but do not, at the same meeting, pass a resolution choosing as the new RE a company that consents to be RE.[213]

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206 ss 601NB, 601NE(1)(b) and s 9 definition of 'extraordinary resolution'.
207 s 252B.
208 s 601NC.
209 RI Barrett, 'Insolvency of registered managed investment schemes', Paper delivered at the Conference of the Banking and Financial Services Law Association, Queenstown, July 2008), p 11.
210 s 601NC(2), (3).
211 s 601NC(2)(b).
212 s 9 definition of 'extraordinary resolution'.
213 s 601NE(1)(d).

6.1.2 Initiating a winding up by court order

The court may, on application by the RE, a director of the RE, an MIS member or ASIC, direct the RE to wind up an MIS.[214] The court may act where it 'thinks it is just and equitable to make the order'.[215]

In contrast with the winding up of a company,[216] there is no express ground for the court to direct the winding up of an MIS on the basis that it is insolvent.[217] However, there is judicial authority that a winding up order on the just and equitable ground may be made where:

- the MIS is insolvent, or
- the RE is insolvent and cannot continue to perform its functions and no replacement RE can be found.[218]

The court may also order the RE to wind up an MIS on application by a creditor with an unsatisfied execution on a court order.[219]

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214 s 601ND.

215 s 601ND(1)(a), (2).
A winding up on the just and equitable ground might be permitted where 'the administration and original arrangement had broken down': *Capelli v Shepard* [2010] VSCA 2 at [86], citing *Australian Securities and Investments Commission v Knightsbridge Managed Funds Ltd* [2001] WASC 339 at [63]. See also *Re PWL; ex parte PWL Ltd (formerly Palandri Wines Ltd) (administrators appointed) [No 2]* [2008] WASC 232 at [43], cited in *Capelli v Shepard* [2010] VSCA 2 at [87].
The case law on the winding up of corporations on the just and equitable ground informs the application of this section: *Capelli v Shepard* [2010] VSCA 2 at [104].

216 s 459P.

217 N D'Angelo, 'When is a trustee or responsible entity insolvent? Can a trust or managed investment scheme be "insolvent"?' (2011) 39 *Australian Business Law Review* 95 discusses the issues involved in determining whether an MIS is 'insolvent'.

218 *Rubicon Asset Management Limited* [2009] NSWSC 1068 at [21], [25]. See also *Re Orchard Aginvest Ltd* [2008] QSC 2, *Re PWL; ex parte PWL Ltd (formerly Palandri Wines Ltd) (administrators appointed) [No 2]* [2008] WASC 232, *Capelli v Shepard* [2010] VSCA 2 at [104].

219 s 601ND(1)(b), (3). It has been said that this ground 'obliquely suggests insolvency, as an execution returned unsatisfied in favour of a creditor echoes a traditional act of bankruptcy or its corporate equivalent': *Capelli v Shepard* [2010] VSCA 2 at [80].
Under the ALRC/CASAC recommendation, this was a presumption of insolvency rather than a separate ground for winding up: vol 2, draft s 581AD(5) (p 219).

The court may direct a TRE to wind up the MIS if a meeting to choose a new RE is not held within three months of the appointment of the TRE[220] or the meeting was called but did not result in the members choosing a new RE that consented to act in that role.[221] This order can be made on the application of the TRE or, if the TRE does not apply, on the application of ASIC or a member of the MIS.[222]

6.1.3 Responsibility for conducting the winding up

There are no stipulated legislative procedures for winding up an MIS, other than that it be conducted in accordance with the constitution of the MIS and any orders of the court.[223]

The RE

The responsibility for winding up an MIS rests in the first instance with the RE.[224]

This situation can be contrasted with company windings up, which are always under the control of an external liquidator, whether or not the company is solvent. Also, the ALRC/CASAC report recommended that a registered liquidator be appointed to wind up an

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RI Barrett, 'Insolvency of registered managed investment schemes', Paper delivered at the Conference of the Banking and Financial Services Law Association, Queenstown, July 2008), pp 3-4 expressed doubts about how this ground can be sensibly applied, observing that:

- trust property itself cannot be taken in execution by the creditors of a trustee (*Octavo Investments Pty Ltd v Knight* [1979] HCA 61; (1979) 144 CLR 360 at 367)
- the trustee's equitable interest in the whole of the trust assets is inseparable from the trustee's obligations and therefore cannot be taken in execution (even in jurisdictions where statute empowers the sheriff to take equitable interests in specific property under the common law process of execution of a writ of attachment)
- an unsuccessful attempt at execution at law says nothing about the sufficiency of the trustee's rights against the trust property to meet the creditor's claim established by judgment or the financial health of the scheme (though the trustee's lack of non-trust assets may indicate that the RE itself is financially stressed and perhaps should be replaced).

220 s 601FQ(5)(a).

221 s 601FQ(5)(b).

222 s 601FQ(5).

223 ss 601NE, 601NF.

224 s 601NE. As observed in *Re Environinvest Ltd* [2009] VSC 33 at [65]:

> Winding up the scheme is plainly part of the business of the responsible entity.

MIS that has been terminated, whether the termination is by court order[225] or otherwise.[226]

Other parties

The court, upon application by the RE, a director of the RE, a member of the MIS, or ASIC, may make an order appointing a person other than the RE to take responsibility for ensuring that an MIS is wound up in accordance with its constitution and any directions that the court makes.[227]

The court may make such an order if it 'thinks it necessary to do so (including for the reason that the responsible entity has ceased to exist or is not properly discharging its obligations in relation to the winding up)'.[228]

There is no statutory restriction on whom the court may appoint to take responsibility for ensuring the winding up of an MIS. For instance, if the court thinks it appropriate, it could appoint the liquidator of the RE as the liquidator of the MIS as well. The liquidator of the RE would have the power to make application in the name of the RE.

Powers of the court

The court may, upon application by the RE, a director of the RE, an MIS member or ASIC, give directions about how an MIS is to be wound up. The court may act 'if the Court thinks it necessary to do so'.[229] The court may also be able to act under its inherent powers, for instance in relation to trusts.

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225 vol 1, para 8.12 (rec 64, p xxix), vol 2, draft ss 581BA, 581BB(1) (p 220). For companies, cf ss 472, 532(1), (8), the latter subsection requiring that a court-appointed liquidator be an official liquidator.

226 vol 1, para 8.12 (rec 64, p xxix), vol 2, draft ss 581BA, 581BB(2) (p 220). For companies, cf ss 495, 532(1) in relation to a members' voluntary (that is, a solvent out of court) winding up (except that the liquidator of a proprietary company does not have to be registered: s 532(4)) and ss 499, 532(1) in relation to a creditors' voluntary (that is, an insolvent out of court) winding up.

227 s 601NF.

228 s 601NF(1), (3).

229 s 601NF(2), (3).

6.1.4 Application to practice

While the provisions outlined above contemplate various means of winding up an MIS, they are drafted principally from the perspective of a single MIS, with the provisions relating to the role of its RE focusing primarily on the RE's conduct of that MIS. As they stand, they may not adequately deal with some of the complex issues that can arise when commercial enterprises, which may involve numbers of MISs operated by multi-function REs, experience financial stress.

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?

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
- is there a need for a separate insolvency ground for winding up an MIS
- if so:
  - how should the insolvency of an MIS be defined
  - should unsatisfied execution be a presumption that this ground is satisfied, rather than a separate ground, as at present?

6.2 Liquidation of an MIS where the RE is solvent

A solvent RE (whether it be a sole function or a multi-function RE) may wish to liquidate an MIS for various reasons, including where the RE considers that the purpose of the MIS cannot be achieved or that the scheme property is, or will be, insufficient to meet the indemnity claims of the RE in operating the scheme.

As indicated in Section 6.1, Part 5C.9 of the Corporations Act sets out the procedure for an RE to initiate the liquidation process, with

the MIS members entitled to pass an extraordinary resolution concerning the proposal by the RE.[230]

Where the RE is solvent, there would be no external unsatisfied MIS creditors if the reforms in Chapter 3 are adopted, given the right of those creditors to claim against the RE as well as against property of the MIS.

The legislation does not regulate the process by which an RE winds up a scheme. This is left to the scheme constitution and any general law and trust principles. This lack of legislative direction raises the question whether, or in what respects, a more regulated liquidation procedure may be necessary to protect the interests of members. A possible precedent, if some legislative initiative is warranted, is the members' voluntary winding up procedure for companies (Part 5.5 Divs 2 and 4).

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?

6.3 Whether MIS of an insolvent RE needs to be wound up

6.3.1 Sole function insolvent RE

The insolvency of a sole function RE does not necessarily point to a need to wind up its MIS.

Where unnecessary to wind up the MIS

In some cases, the financial stress of a sole function RE may not affect the property of the MIS. For instance, the RE may be insolvent in consequence of transactions it has entered into, ostensibly as operator of the MIS, but in fact beyond power so that it has no indemnity rights against the property of the MIS. The MIS may have sufficient unencumbered property to remain viable.

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[230] s 601NC.

In these circumstances, the continuation of the MIS may involve severing the link with the insolvent RE, including through the appointment of a TRE as an interim measure in anticipation of attracting a new RE (Chapter 4).

Where necessary to wind up the MIS

In other circumstances, the insolvency of a sole function RE may also trigger the need to wind up the MIS. For instance, a trust-based MIS may have little or no scheme property to continue its operations, once claims against that property (under Reform 4) are taken into account.

6.3.2 Multi-function insolvent RE

The insolvency of a multi-function RE may or may not point to the need to wind up one or more of the MISs that it has operated.

Where unnecessary to wind up an MIS

The financial stress of a multi-function RE may affect some, but not all, of the MISs that it has operated. For instance, the RE may only be in financial stress because of the way that it has conducted particular MISs. It may also have incurred substantial losses through commercial activities unrelated to its operation of MISs.

On the assumption that the legislative reforms proposed in Chapter 3 are enacted (including Reform 4 by which the unencumbered property of each MIS is available only to the creditors of that MIS and to the RE in respect of its lawful claims against that property), an MIS may have sufficient residual scheme property to remain viable in its own right, notwithstanding the insolvency of its RE. The continuation of the MIS would depend on attracting a new RE, which may involve the appointment of a TRE as an interim measure (Chapter 4).

Where necessary to wind up an MIS

In other circumstances, the insolvency of the RE may trigger the need also to wind up some or all of its MISs. For instance, a trust-based MIS may have little or no scheme property needed for its operations, once lawful claims against that property are considered (if Reform 4, as proposed in Chapter 3, is adopted).

6.4 Combined or separate liquidations

The process of liquidating an insolvent MIS where its sole function or multi-function RE is also insolvent will typically begin with the RE going into either VA or liquidation:

> The normal course is that a voluntary administrator, receiver or liquidator will be appointed to the insolvent RE. The external administrator then assumes responsibility for liquidating the MIS, or he or she asks the court to appoint a different liquidator to the MIS.[231]

6.4.1 The VA route

The RE may first be put into VA at the instigation of its directors or other parties.[232]

Under current law, the 'affairs' of an RE, for the purpose of its VA, include the affairs of any of its MISs.[233] This would allow the administrator of the RE also to deal with the affairs of the insolvent MIS in this context. Currently, there is no provision for the separate VA of an MIS. However, the issue has been raised elsewhere in this paper (Chapter 5) of introducing a separate VA procedure for an MIS, at least in certain circumstances.

If separate VAs of an RE and an MIS that it operates were to take place, the question arises whether, or in what circumstances, that separation should continue if the RE and the MIS subsequently go into liquidation.

6.4.2 The liquidation route

In some instances, the level of financial stress being experienced by an RE may suffice for the decision to be made to place the RE immediately in liquidation, bypassing the VA procedure.

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231 J Ball & J Moutsopoulos, 'The Ultimate Intangible: 'Insolvent' Unit Trusts in Australia' *Insol World* (First Quarter 2011) 10 at 11.

232 ss 436A, 436B, 436C.

233 The definition of 'affairs' in s 53 includes its affairs as 'trustee'. In *Porter v Miller Street Pty Ltd* [2008] FCAFC 77 at [44]-[46], the Court observed that steps taken by the liquidator of a company concerning property held by the company in trust for others are steps taken in winding up the affairs of the company.

In this event, the question arises whether, or in what circumstances, there should be a combined or separate liquidation of the RE and one or more of the insolvent MISs.

6.4.3 Position of secured creditors

During the operation of an MIS, its RE may have lawfully provided property of the MIS as security for transactions concerning that MIS. In the event of the external administration of the RE and the MIS, the legal rights of a secured creditor, which may include appointing a receiver to affected property, would remain, regardless of whether a combined or separate RE and MIS liquidation took place.

6.4.4 Potential conflicts in combined liquidations

One of the tasks of the liquidator of a company may be to deal with the affairs of any trust for which the company was the trustee:

> In my view, in a case where a company has acted as trustee, the liquidator's duty will include in an appropriate case, such matters as the identification of the trust's constituent document, the ascertainment of the nature and value of the trust assets and trust liabilities, the investigation of the financial relationship between the trustee and the trust, the identification of the trust's creditors and beneficiaries and any matters necessary to determine appropriate action to be taken in relation to the trust on behalf of the trustee including action to preserve and protect assets or to wind up the trust where appropriate and there is express power to do so.[234]

However, difficulties can arise if the liquidator of an RE also acts as the liquidator of one or more of the MISs that had been operated by the RE.

As an RE is a company, the liquidator of an RE becomes an officer of the RE,[235] with duties to act in the best interests of the RE,[236] including, in the case of liquidation, the interests of the creditors of

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234 *Irvine v Australian Sharetrading and Underwriting Ltd (in liq)* (1996) 22 ACSR 765 at 783.
235 Paragraph (f) of the s 9 definition of 'officer' of a corporation.
236 See particularly ss 180-181.

the RE.[237] However, an officer of an RE also has various statutory duties, including an obligation to act in the best interest of MIS members and, if there is a conflict between the members' interests and the interests of the RE, to give priority to the members' interests.[238]

The liquidator could seek directions from the court (under its inherent powers) for guidance and also protection from liability. The court in one instance expressed the view that the statutory duties of an officer of the RE do not require the liquidator of the RE, in that capacity, to place the interests of MIS members above those of creditors of the RE.[239]

In practice, however, real or perceived conflict problems may remain. An example concerns the exercise of indemnity rights of the RE against the property of the insolvent MIS. The right of indemnity can only lawfully be claimed where the RE has acted within its powers as operator of the MIS. The liquidator of the RE might be seen as being in a position of conflict between:

- exercising that right (or not challenging past exercises of that right by the RE), thereby increasing the assets of the RE, and
- not exercising that right (on the view that the RE has acted beyond its powers in particular circumstances), thereby increasing the residual property of the MIS.

This raises the question whether the method of appointment of a liquidator, the legal requirements to be independent and to be perceived as independent, and the other duties that the liquidator

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237 *Kinsela v Russell Kinsela Pty Ltd (in liq)* (1986) 10 ACLR 395, *The Bell Group Ltd (in liq) v Westpac Banking Corporation (No 9)* [2008] WASC 239 at [4396]-[4450].

238 s 601FD(1)(c).

239 *Timbercorp Securities Limited (in liq) v WA Chip & Pulp Co Pty Ltd* [2009] FCA 901 at [11].

owes (as well as any duties that the RE has as trustee) need to be reframed to resolve these types of conflict.[240]

Having separate liquidators of the RE and an MIS may be one way to overcome real or perceived conflicts. However, it should be recognised that separate appointments may lead to disputes that may have to be settled through litigation. For instance, the RE liquidator may seek to assert an indemnity claim against the MIS property while the MIS liquidator may reject that claim.

6.4.5 Liquidation costs

An advantage of the liquidator of the RE also being the liquidator of the MIS is the likely saving in administrative time and cost. Having separate liquidations, and liquidators, of an RE and an insolvent MIS could add to overall liquidation costs, to the detriment of affected creditors.

6.4.6 Application of proposed reforms

The reforms proposed in Chapter 3 would facilitate the separate liquidation of an MIS. Reform 1 would ensure the separate identification of the affairs of each MIS. Reform 4 would secure the rights of the creditors of each MIS against the property of that MIS.

Those proposed reforms may, however, complicate the liquidation of an RE. MIS creditors who (in exercising their rights under Reform 4) do not recover in full from the relevant property of the MIS would have residual rights in the liquidation of the RE. The liquidator of the RE may be unable fully to identify the level of claims against the RE until the liquidations of MISs that had been operated by that RE were completed (or at least had reached the point where the level of recovery by creditors of each affected MIS could be determined).

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[240] M Broderick, 'Managed investment schemes—winding up and stakeholder entitlements: Part I' (2006) 17 *Journal of Banking and Finance Law and Practice* 186 at 193 referred to 'the integrity of liquidators, who owe duties to the court of the highest nature' and stated that '(q)uite sensibly, now liquidators are often appointed to both a scheme and its corporate operator, as in *ASIC v Fuelbanc Australia Ltd* [2006] FCA 940.'

6.4.7 Current power to initiate a separate liquidation

There is already a power for the court, upon application by the RE, a director of the RE, an MIS member or ASIC, to appoint a person other than the RE to wind up an MIS 'if the Court thinks it necessary to do so (including for the reason that the responsible entity has ceased to exist or is not properly discharging its obligations in relation to the winding up)'.[241] An MIS creditor is not eligible to make an application.

In practice, problems have arisen where the court has sought to appoint a separate liquidator of an MIS. In one case, the court ordered that a separate liquidator be appointed to an MIS, even though it considered that the liquidator of the RE could 'discharge the responsibility of winding up the schemes, provided adequate measures were put in place to ensure that any possibility for conflict could be dealt with by appropriate undertakings and directions'.[242] However, the court also ordered that the RE and its receivers be indemnified for their costs and expenses in priority to those of the liquidator of the MIS.[243] When no-one was prepared to become liquidator of the MIS on those terms, the court appointed the liquidator of the RE as the liquidator of the MIS.[244]

This outcome points to the need to make clear against what assets the liquidator of an MIS and the liquidator of an RE that operated that MIS could claim for their remuneration and expenses, and their relative rights if the same property is involved.

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?

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241 s 601NF(1).
242 *Re Environinvest Ltd* [2009] VSC 33 at [134].
243 id at [146].
244 J Ball & J Moutsopoulos, 'The Ultimate Intangible: 'Insolvent' Unit Trusts in Australia' *Insol World* (First Quarter 2011) 10 at 11.

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
- against what property might the claims of the RE liquidator and the MIS liquidator concerning their costs and expenses be claimed, and what would be their respective rights if the same property is involved?

6.5 Options for an MIS liquidation process

There are no detailed legislative procedures for the liquidation of an MIS. Furthermore, the view has been taken that the court's power to give directions about how a registered scheme is to be wound up[245] does not extend to imposing detailed procedural requirements, in particular requirements affecting third parties:

> In my view, Parliament deliberately did not apply the regime for the winding-up of companies to the winding-up of registered schemes. It could have, but it did not, provide for the appointment of a liquidator to the affairs of a registered scheme, who is independent of the responsible entity. It could have, but it did not, make the provisions which regulate the winding-up of companies applicable to the winding-up of registered schemes, including, for example, the power to apply to the Court for the issue of examination summonses. It did not give the Court powers of the kind described in s 447A in relation to administrations and deeds of company arrangement. I do not read the power to give directions in s 601NF(2) in the wide way for which the plaintiff contends, as in effect, permitting the Court, by order, to impose a new legislative regime on the winding-up of a particular scheme, and thereby affecting the rights of and imposing duties on third parties.[246]

One option would be to give the court greater powers to determine the procedure for winding up any MIS. Currently, the court has a

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245 s 601NF(2).
246 *Stacks Managed Investments Ltd* [2005] NSWSC 753 at [55].

power, in the winding up of an unlawful unregistered MIS, to 'make any orders it considers appropriate for the winding up of the scheme'.[247] The court has exercised this power on numerous occasions. This power could be extended to all MISs.

Another option would be to introduce a more detailed legislative procedure for the winding up of an MIS, as outlined in Section 6.6.

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?

6.6 Possible elements of an MIS liquidation procedure

6.6.1 Overview

What is involved in the liquidation of a trust-based MIS was usefully summarised in one case as follows:

> Where the scheme is a trust, what is envisaged by the winding-up of a scheme is the realisation of its property, the payment by the responsible entity of liabilities incurred on behalf of the scheme or the retention by it of funds with which to meet its liabilities, the ascertainment of the members' entitlements, and the distribution of the trust assets to the members in accordance with their entitlements. The winding-up of a trust involves the performance of the trust, by the trustee's accounting to the beneficiaries for trust property in accordance with the terms of the trust, and its termination.[248]

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247 s 601EE(2).
248 *Stacks Managed Investments Ltd* [2005] NSWSC 753 at [42].

The Court also observed[249] that winding up a trust is quite a different thing from winding up a company:

> Because the scheme, where it is a trust, is not a legal entity, the expression "scheme creditors" is at best a shorthand expression for those creditors of the responsible entity in respect of whose debts the responsible entity is entitled to be indemnified out of the scheme assets.

The reference by the Court to the 'payment by the responsible entity of liabilities incurred on behalf of the scheme' indicates the need to identify the rights, liabilities and obligations of the RE in respect of each MIS that it operates (Reform 1). The concept of 'MIS creditors' and their rights vis–à-vis other creditors of the RE are dealt with in Reform 4.

6.6.2 Procedural matters

There are detailed statutory procedures and requirements for the winding up of a company. By contrast, Part 5C.9 of the Corporations Act contains no detail about the procedure for winding up an MIS, merely stating that the RE 'must ensure that the scheme is wound up in accordance with its constitution and any orders' of the court.[250]

The ALRC/CASAC report envisaged a series of procedural powers and obligations in the winding up of an MIS.

These included a power for the liquidator of an MIS to apply to the court for the compulsory examination of persons in relation to the MIS, in the same way as the liquidator of a company.[251]

Other matters recommended by the report included:

- provisions relating to the protection of scheme property[252]

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249 at [44].

250 s 601NE.

251 vol 2, draft amendments to ss 596A, 596B of the corporations legislation (p 229). The liquidator would have to give notice of an examination to as many of the creditors of the MIS as reasonably practicable: vol 2, draft amendment to s 596E of the corporations legislation (p 229).

252 Court powers relating to prohibiting officers from removing relevant property from the jurisdiction, appointing a receiver and surrendering passports are dealt with in vol 2, draft s 486AA (pp 214-215) (cf s 486A(1), (2) for companies).

- duties of the liquidator, including to report to ASIC on any wrongdoing by relevant persons[253] and to keep proper books,[254] as well as certain requirements relating to money received by a liquidator[255]

- a requirement for officers of the RE to give assistance to the liquidator[256]

- court powers to make various orders, including for the delivery of property to the liquidator,[257] to make such orders as are just[258] and to make appropriate orders concerning persons guilty of misconduct causing loss to an MIS[259]

- public notification requirements[260]

- a prohibition on an RE issuing or accepting new subscriptions related to a particular MIS after the termination of the MIS without the leave of the court or carrying on business of the MIS except so far as the MIS liquidator permits for the better winding up of the MIS[261]

A court power to issue an arrest warrant is dealt with in draft replacement s 486B(1)(a), (3)(a), (b), (c) (p 216), which apply to MISs as well as companies and replace the current provisions that apply to companies only.

253 vol 2, draft s 581DI (pp 227-228). For companies, cf s 533. The liquidator would have qualified privilege for the liquidator in performing this function: vol 2, draft s 581DK (p 228) (cf s 535 for companies).

254 vol 2, draft s 581DJ (p 228). Cf s 531 for companies. A liquidator of a company must keep books containing entries or minutes of proceedings at all meetings and any other matters required to give a complete and correct record of the liquidator's administration of the company's affairs (s 542; Corp Reg 5.6.01). The liquidator must make the books available for inspection at the liquidators' office, in the absence of a court order (s 542; Corp Reg 5.6.02).
Other possible duties are to have regard to directions given by creditors (cf s 479(1) for companies in a court winding up) and to convene meetings of creditors in certain circumstances (cf s 479(2) for companies in a court winding up).

255 Cf s 538 for companies.

256 vol 2, draft ss 581DG (p 226), 581DH (pp 226-227). For companies, cf ss 475, 494, 530A.

257 For companies, cf s 483.

258 vol 2, draft s 581DL (p 228). Eligible applicants would be ASIC, the liquidator or an interested person.

259 vol 2, draft amendment to s 598 of the corporations legislation (p 229).

260 vol 2, draft s 581BI (p 222). For companies, cf ss 537, 541.

261 vol 2, draft s 581DB (p 225). For companies, cf s 471A.

- provisions voiding an enforcement action against scheme property[262] or a transfer of interests or alteration in the status of scheme investors.[263]

Questions

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

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
- have obligations to report to ASIC comparable to those of the liquidator of a company, including in relation to possible unlawful activity?

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?

Is there a need for any legislative procedures for winding up an MIS to be varied to take into account the particular characteristics of MIS structures (trusts, partnerships, contract-based MISs)? If so, what?

A liquidator who forms the view that an MIS may be viable could utilise the VA process (discussed in Chapter 5), if implemented.

6.6.3 Rights of priority creditors

There is no provision in Chapter 5C for an order of priority for the distribution of scheme property in the winding up of an MIS.[264]

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262 vol 2, draft s 581DD (p 225). For companies, cf s 471B.

263 vol 2, draft s 581DE (p 225). For companies, cf s 468A.

264 In *Stacks Managed Investments Ltd* [2005] NSWSC 753 at [44], the Court said:

> There can be no question of settling an order of priority of "scheme creditors", or of precluding "scheme creditors" from taking or continuing proceedings for the recovery of their debts, or requiring them to submit to a process of lodgement of proof of debts with consequent appeals to the court from a decision on the acceptance or rejection of proofs.

By contrast, the Corporations Act stipulates that debts and claims in the winding up of a company rank equally,[265] subject to certain priority payments.[266]

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?

6.6.4 Voidable transactions

The Corporations Act contains voidable transaction provisions, which seek to protect the interests of unsecured creditors of an insolvent company that is being wound up. These provisions[267] give the court powers to set aside particular transactions that were entered into by the company before the winding up began and may give an undue advantage to counterparties or beneficiaries of those transactions over other creditors in obtaining payment out of corporate assets.[268]

The question is whether any MIS winding up provisions should include voidable transaction provisions and, if so, what.

If Reform 4[269] is adopted, the view might be taken that there should be voidable transaction provisions for MISs, as any recovery should be available in the first instance at least only to the creditors of the particular MIS. Reliance on court action by the liquidator of the RE to recover voidable transactions under the corporate winding up provisions would result in the proceeds of those actions being

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The ALRC/CASAC report envisaged that property of an MIS being wound up would be distributed first in payment of scheme liabilities and then to MIS members (vol 1, para 8.11; vol 2, draft s 581DF (pp 225-226)). The report observed that provisions for proofs of debt, based on the Corporations Act (Part 5.6 Division 6 Subdivision D) and Regulations (Part 5.6) would be required: vol 1, p 78, footnote 32.

265 s 555.

266 s 556.

267 Pt 5.7B Div 2.

268 V Jewell, 'Corporate law' in I Freckelton & H Selby (eds), *Appealing to the Future: Michael Kirby and his Legacy* (ThomsonReuters, Sydney, 2009) at 160.

269 See Section 3.4.2.

available for the RE's creditors generally, rather than just the creditors of the particular MIS, contrary to Reform 4.

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?

6.6.5 Access to books of the MIS

A corporate liquidator must keep books containing entries or minutes of proceedings at all meetings and any other matters required to give a complete and correct record of the liquidator's administration of the company's affairs.[270] The liquidator must make the books available for inspection by creditors or contributories, subject to any contrary court order.[271]

These provisions provide creditors and contributories with a means to monitor the progress of the winding up, as well as to obtain information relevant to any proceedings that they may initiate or in which they are involved.

Arguably, comparable provisions should apply in the liquidation of an MIS.

Question

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

6.6.6 Court power to give directions

Currently, the court, upon application by the RE, a director of the RE, a member of the MIS or ASIC, may give directions about how an MIS is to be wound up.[272] Where the court appoints someone

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270 s 531; Regulation 5.6.01.
271 s 531; Regulation 5.6.02.
272 s 601NF.

other than the RE to wind up an MIS, it may also give directions concerning that winding up.[273]

It has been held that:

- a court cannot give directions of its own motion
- a court can probably only give directions to deal with an actual conflict, not potential conflicts.[274]

It has also been held that the power of the court to give directions does not authorise it to confer additional powers to which third parties would be subject, or to interfere with the rights that third parties would otherwise enjoy.[275]

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?

6.6.7 Position of MIS members

The PJC report noted the concern expressed by members of some failed agribusiness MISs that in the liquidation of the MIS no person was charged solely with representing their interests.[276]

Where an MIS is being liquidated, its members may have property or contractual rights, particularly in contract-based MISs based on a common enterprise rather than the pooling of funds. It is for the liquidator to assess these claims, including the significance that they may have for determining what constitutes the property of the MIS.

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273 s 601NF(1), (2).
274 *Re Orchard Aginvest Ltd* [2008] QSC 2.
275 *Stacks Managed Investments Ltd* [2005] NSWSC 753 at [52], *Capelli v Shepard* [2010] VSCA 2 at [146].
276 Paragraphs 3.103 and 3.104.

Beyond that, appointing a person to represent MIS members in the winding up of a scheme would be out of step with comparable corporate liquidation practice. Where a company goes into liquidation no one is appointed specifically to look after shareholder interests.

As earlier indicated (Section 6.4.4), a liquidator of an RE, like any other officer of the RE, has a statutory duty to act in the best interests of MIS members. This can affect the role of an RE liquidator who is also winding up an MIS operated by that RE. The question arises whether a liquidator in a stand-alone MIS liquidation process should have a comparable statutory duty, or whether that person should be in the same position in relation to members as the liquidator of a company in relation to shareholders.

Questions

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

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

6.7 Unregistered MISs

The current law on the winding up of unregistered MISs[277] focuses on MISs that should be, but have not been, registered. In principle, the legislation should make appropriate provision for three different types of unregistered MISs:

- lawful unregistered MISs
- unlawful unregistered MISs that are viable
- unlawful unregistered MISs that are not viable.

[277] s 601EE.

6.7.1 Lawful unregistered MISs

The Corporations Act sets out the circumstances in which an MIS must be registered.[278] MISs that do not fall within the stipulated circumstances are exempt from registration under the corporations legislation, for instance various small MISs where interests are not offered to the public.

Grounds for winding up

There is no legislative framework providing for the grounds on which this type of MIS might be wound up or the winding up procedure to be followed.

> ***Question***
>
> Are the grounds for winding up a registered MIS (see Section 6.1.1) equally applicable to a lawful unregistered MIS?

Procedure for winding up

The draft procedural provisions for winding up an MIS in the ALRC/CASAC report applied to MISs whose constitutions provide that the RE is to hold the scheme property.[279] Many (if not most) unregistered MISs do not have an RE.

> ***Question***
>
> Should there be any provisions governing the procedure to be followed in winding up lawfully unregistered MISs and, if so, what?

6.7.2 Unlawful unregistered MISs that are viable

In appropriate cases, these MISs can become registered through consultation with ASIC.

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[278] s 601ED.
[279] vol 2, draft ss 581DA (p 225).

Question

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

6.7.3 Unlawful unregistered MISs that are not viable

The Corporations Act provides for the court to wind up an unlawful unregistered MIS, on application by ASIC, the person operating the scheme or a scheme member.[280] The Court may make any orders it considers appropriate for the winding up of the scheme.[281]

Standing to apply for winding up

Currently, only a current member of an unregistered MIS has standing to apply for its winding up. A former member or a person entitled to be registered as member has no standing.

Also, a creditor has no standing to apply for the winding up of an unregistered scheme. The creditor would have to apply for the winding up of the RE, if any.

Questions

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

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

280 s 601EE.
281 s 601EE(2).

7 Other matters

This chapter discusses the request in the terms of reference to examine proposals concerning convening scheme meetings, cross-guarantees entered into by REs on behalf of other group members and statutory limited liability of scheme members. It also invites submissions on any other matters concerning the general operation of the MIS regime.

7.1 Convening scheme meetings

The reference from the PST asked CAMAC to consider the convening of scheme meetings.

An RE has various powers to call a meeting of scheme members.[282] Likewise, a threshold number of members can require the RE to call a meeting of members to remove the RE or otherwise consider a proposed special or extraordinary resolution, or call a meeting in their own right.[283] The court may also order a meeting to be held to consider either type of resolution, on the application of the RE, or any scheme member, 'if it is impracticable to call the meeting in any other way'.[284] There are statutory procedures dealing with the process of calling, holding and voting at these meetings.[285]

ASIC does not have the power to convene meetings of scheme members.

Likewise, there is no provision for an annual general meeting of scheme members or a right for members to requisition a general meeting, except for the specific purposes set out in the legislation. On one view, annual general meetings and extraordinary general meetings for MISs would 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.

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282 ss 252A, 601FL.
283 ss 252B-252D, 601FM.
284 s 252E.
285 Part 2G.4 Divs 2-6.

The Turnbull Report recommended that provision be made in the legislation for members to request the RE of a registered scheme to call a general meeting.[286]

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?

For what purposes, if any, should ASIC be granted the power to convene meetings of members?

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

7.2 Cross-guarantees

The reference from the PST asked CAMAC to consider cross-guarantees entered into by an RE on behalf of other group members.

An RE that is in a corporate group may be requested, as part of the group's activities, to provide guarantees or indemnities for various transactions by other companies in that group. These types of financial accommodation may take two forms:

- guarantees or indemnities provided by the RE in its personal capacity, unrelated to its operation of any MIS
- guarantees or indemnities provided by the RE in its capacity as the RE of an MIS. This could involve permitting a third party to take a fixed or floating charge over property of an MIS held by the RE as operator of that scheme.

There are currently no significant restrictions in regard to an RE entering into this form of financial arrangement with its own assets. However, these forms of financial commitment can expose the RE to financial risk from other activities in the group, with the possibility

[286] rec 7.

of the RE becoming insolvent or otherwise no longer capable of performing its functions as a scheme operator. This can cause disruption to the operation of any MISs that the RE operates, including the need to attract and appoint a TRE or new RE to each affected MIS to avoid the liquidation of the MIS.

Imposing a legal impediment on the property of an MIS in consequence of providing a guarantee or indemnity that is unrelated to the activities of that MIS may be a breach of trust by the RE, unless expressly permitted in the constituent documents of the MIS.[287] However, that legal protection for scheme property may prove illusory, given the opportunity for scheme promoters when designing schemes to draw up constitutions permitting the RE to provide such financial support.

ASIC Consultation Paper 140 *Responsible entities: Financial requirements* (September 2010) proposes that the licensing requirements for REs be amended so that an RE:

- is prohibited from providing guarantees in its capacity as the RE of a scheme
- where the RE manages more than one scheme, is prohibited from providing guarantees in its personal capacity
- is restricted from providing indemnities in its capacity as the RE of a scheme, other than indemnities in relation to the scheme's default.

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?

[287] Paragraph 601GA(1)(b) requires the constitution of an MIS to make adequate provision for the powers of the RE in relation to making investments of, or otherwise dealing with, scheme property.

7.3 Limited liability of MIS members

The reference from the PST asked CAMAC to consider statutory limited liability of scheme members.

Inquiries conducted by the Companies and Securities Law Review Committee (1984), the ALRC/CASAC in their collective investments review (1993) and CASAC in its review of the liability of members of managed investment schemes (2000) have recommended statutory provisions to the effect that (except under arrangements whereby the RE is acting as agent for the MIS members) the members of an MIS should have limited liability for scheme debts that remain outstanding on the winding up of an MIS, in the same manner as shareholders of a company limited by shares.[288]

Further information on these reviews, and the full details of the recommendations by CASAC, are found in the CASAC 2000 report *Liability of Members of Managed Investment Schemes* (March 2000), which can be found on the CAMAC website **www.camac.gov.au** by going to *Publications*, and then to *Reports*.

The recommendation in the 2000 CASAC report to introduce limited liability for members of registered and ASIC-exempt MISs (but not other unregistered MISs) was based on these persons being passive investors, who, in principle, should have similar protections against personal liability, whether they invest in MISs or in limited liability companies.

However, in some MIS arrangements, particularly in the agribusiness sector, some scheme members have sought to be characterised as playing a much more active role, as 'growers' carrying on their own individual businesses, with property interests in agricultural land or its produce. This raises the question whether, or in what circumstances, they should not have the protection of limited liability.

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[288] See also the discussion at Section 2.6.2 of the Turnbull Report.

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?

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

7.4 Other matters

The PST letter stated that:

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

Question

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

Appendix Terms of reference

The regulation of managed investment schemes

Since the passage of the *Managed Investments Act 1998*, collective investments, known as managed investment schemes (MIS), have been regulated by Chapter 5C of the *Corporations Act 2001* (the Corporations Act). The Corporations Act provides that the main features of a MIS are that:

- people are brought together to contribute money to get an interest in the scheme;
- money is pooled together with that of other members or used in a common enterprise; and
- members do not have day to day control over the operation of the scheme.

While the overwhelming majority of funds under management in Australian MIS are placed in schemes structured as unit trusts, where investors hold units in the scheme property, the MIS structure has also been applied in the agribusiness sector where the members (known as 'growers') operate their own individual businesses.

The recent global financial crisis highlighted the difficulties that arise for responsible entities (REs), scheme members, and creditors where a MIS comes under financial stress in a credit constrained environment. Those difficulties were evidenced initially through the freezing of investor redemptions in the mortgage fund sector, and then through the collapse of a number of significant participants in the agribusiness MIS market.

The collapse of Great Southern Limited and Timbercorp Group led the Parliamentary Joint Committee on Corporations and Financial Services (PJC) to initiate an inquiry into agribusiness managed investment schemes. Submissions to the inquiry highlighted a range of concerns relating to the regulation of agribusiness, including in relation to: the provision of narrow sales recommendations; the 'one size fits all' licensing model; the accuracy of disclosure material available to investors, especially in relation to predicted scheme

performance; the appointment of temporary REs; and better investor education. *The PJC released its report, Aspects of agribusiness managed investment schemes, on 7 September 2009.*

In that report, the PJC made three recommendations relating to agribusiness MIS.

- Recommendation 1 related to the tax treatment of agribusinesses.

- Recommendation 2 was that the Government amend the Corporations Act to require ASIC to appoint a temporary RE when a registered MIS becomes externally administered or a liquidator is appointed.

- Recommendation 3 related to ASIC requirements for agribusiness MIS to disclose the qualifications and accreditation of third parties that provide expert opinion on likely scheme performance.

As part of its *Financial products and services in Australia* report released on 23 November 2009, the PJC also recommended that, as part of their licence conditions, ASIC require agribusiness MIS licensees to demonstrate that they have sufficient working capital to meet current obligations (Recommendation 7).

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

It is therefore not clear whether the legislative arrangements contained in the Corporations Act are adequate to maintain the confident participation of retail investors in MIS because of deficiencies in the way the Act deals with: resolving the consequence, for otherwise viable schemes, of the insolvency of

their RE; and what is to occur when the RE is insolvent and the Scheme itself has failed. Informal stakeholder consultations have also raised issues with the general operation of the MIS regime, which has not been reviewed since 2001.

I request that CAMAC:

- examine whether the current statutory framework is adequate for the winding up of MIS, and agribusinesses in particular, and whether it provides the necessary guidance for liquidators, creditors, investors and growers;

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

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

- examine whether REs are unable to restructure a financially viable MIS and advise if the current legislative methods available to companies under the Corporations Act should be adapted to managed schemes; and

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