Managed Investments Law

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MANAGED INVESTMENTS LAW

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Abbreviations

ALRC	Australian Law Reform Commission
ALRC/CASAC *Report No 65*	ALRC/CASAC Report No 65 *Collective Investments: Other People's Money* (2 vols and summary) (1993)
ASIC	Australian Securities and Investments Commission
ASIC Act	*Australian Securities and Investments Commission Act 1989* (Cth)
ASC	Australian Securities Commission
ASX	Australian Stock Exchange Limited
Baxt Black and Hanrahan	Baxt Black and Hanrahan *Securities Industry Law* (6th ed. 1999) (forthcoming)
CASAC	Companies and Securities Advisory Committee
Explanatory Memorandum	Explanatory Memorandum to the Managed Investments Bill 1997 (1997)
Ford, Austin and Ramsay	Ford Austin and Ramsay *Ford's Principles of Corporations Law* (8th ed. 1997)
Ford and Hardingham	Ford and Hardingham "Trading Trusts: Rights and Liabilities of Beneficiaries" in Finn (ed.) *Equity and Commercial Relationships* (1987)
FSI Final Report	Financial System Inquiry *Final Report* (March 1997)
Jacob's Law of Trusts	Meagher and Gummow *Jacob's Law of Trusts in Australia* (6th ed. 1997)
Kam Fan Sin	Kam Fan Sin *The Legal Nature of the Unit Trust* (1997)
1995 Bill	*Collective Investments: Draft Bill and Commentary,* Business Law Division of the Commonwealth Attorney-General's Department, December 1995.

Chapter 1

Introduction

This book is concerned with the legal regulation of Australian managed investment schemes. Public unit trusts are the most common and significant form of managed investment scheme, but the statutory definition is broad and the law applies to a wide range of investment and quasi-investment arrangements. In very general terms, the managed investments laws potentially apply to all types of passive investment or financial arrangements made available to retail investors that are neither structured as corporations nor prudentially supervised.

The Corporations Law is the principal statute regulating the creation and operation of such arrangements. It defines managed investment schemes as schemes to which participants contribute money or money's worth that is pooled, or used in a common enterprise, to produce financial or proprietary benefits, in which the investors do not have day to day control over the operation of the scheme. Generally speaking, such schemes are regulated if they have (or a group of associated schemes has) at least 20 members or are promoted by a person in the business of promoting managed investment schemes. However the regulatory regime examined in this book does not apply to schemes that are themselves bodies corporate, to superannuation, banking or life insurance products or (at least directly) where all issues of interests in the scheme were excluded issues within the meaning of sec 66.

The investment arrangements regulated as managed investment schemes under the Corporations Law divide into two broad categories — investment schemes and enterprise schemes.

The largest category is investment schemes, which are sometimes described as 'managed funds'. Such schemes are often established for the purpose of diversified investment in a class or classes of assets selected by the operator and held or traded for the benefit of the scheme participants. In Australia, such funds are generally established as unit trusts, in which an investor holds a beneficial interest in trust property proportionate to their contribution, and shares rateably in any loss or gain resulting from the operator's investment activities on behalf of the scheme. Often the operators of the scheme are attached to financial services providers such as banks, securities dealers or insurance companies. The underlying assets of the scheme may be real property, infrastructure projects, marketable securities, cash or money market instruments, or a combination of them. Generally the schemes will be open-ended, or units in the scheme will be quoted on the ASX, providing liquidity for investors.

The managed funds industry is a significant, and rapidly growing, sector of the Australian economy.[1] As at 30 June 1998 the consolidated assets of managed funds regulated

1. The Financial System Inquiry identified a significant shift in household savings away from traditional deposit products and towards managed funds as preferred investment vehicles: FSI Final Report 90. The trend is likely to continue.

under this regime exceeded $100 billion. Public unit trusts, the largest part of the sector, had total assets under management of $81.4 billion, trustee company common funds $7 billion, and cash management trusts $17.3 billion. These figures do not include the consolidated assets of superannuation funds, life insurance offices or friendly societies, which are separately regulated. With the consolidated assets of those institutions included, the total value of the managed funds industry exceeds $440 billion, almost outstripping the total market capitalisation of domestic companies listed on the ASX[2] and approaching the total amount on deposit with Australian banks.[3]

The second category can be described loosely as "enterprise schemes". These schemes are generally much smaller scale and may be structured to take advantage of special taxation treatment available under Australian law for particular operations. Livestock and agricultural schemes, smaller scale property investments such as serviced apartment projects or closed-end property syndicates, film schemes and the like fall into this category. Such schemes may be contract based, rather than structured as a trust. Enterprise schemes represent, in dollar value, a small part of the managed investment scheme industry.

The regulatory structure

The creation and operation of managed investment schemes are regulated under relevant provisions of the Corporations Law (including Chapter 5C) and the offer of interests in such schemes under the securities laws in Chapter 7 of the Corporations Law. Chapter 5C commenced on 1 July 1998 and, subject to transitional provisions applying to prescribed interest schemes already in existence as at that date, replaced the former Divisions 5 and 5A of Part 7.12 of the Corporations Law. Chapter 5C represents a substantial departure from the previous regulatory approach and does not have any direct parallel in any major commercial jurisdiction.

Chapter 5C requires that managed investment schemes to which it applies be registered with ASIC. Registered schemes must be operated by a single "responsible entity" that is a public company holding a dealers licence and (at least where it holds scheme property) that acts as trustee for scheme members. The responsible entity is accountable to members for the conduct of the scheme and may be liable to members for the acts and omissions of any agents it appoints.

Schemes must be constituted under a constitution that complies with the requirements of Chapter 5C. The responsible entity must have a "compliance plan" in accordance with which the scheme is operated, and its compliance with the plan must be audited annually and, unless the responsible entity has a majority independent board, monitored by a "compliance committee". Responsible entities, their officers, employees and compliance committee members are subject to statutory duties in relation to the conduct of the scheme,

2. As at 30 June 1998, the total market capitalisation of domestic companies was $488,885 million: ASX *Annual Report 1998*.
3. Australian Bureau of Statistics *Managed Funds, Australia — Catalogue No 5655.0*, June Quarter 1998.

and investors and ASIC (the lead regulator of managed investment schemes) have substantial statutory enforcement rights.

History

Chapter 5C was introduced into the Corporations Law on 1 July 1998, by the *Managed Investments Act 1998* (Cth). It replaced the former Divisions 5 and 5A of Part 7.12, which had regulated the offer and issue of "prescribed interests". Division 5 of Part 7.12 was based in significant part on predecessor legislation derived from Division 5 of Pt IV of the *Uniform Company Acts of 1961*, and required that each prescribed interest scheme be constituted under an approved deed containing prescribed covenants (including a buy-back obligation), be managed by a manager that was a public company holding a dealers licence, and be supervised by an independent trustee or representative approved for that purpose by the predecessor bodies to ASIC.

Following the high profile collapses of some widely held unlisted property trusts in 1990, Attorney General Michael Duffy requested ALRC and CASAC to undertake a review of the legislation regulating prescribed interest schemes. The review process began with the release in September 1991 of ALRC/CASAC *Issues Paper 10*, dealing with all publicly offered investment products, including superannuation. However almost immediately, superannuation was separated out of the inquiry. The regulatory issues concerning superannuation and related funds were addressed in the ALRC/CASAC *Discussion Paper 50* (January 1992) and *Report No 59* (1992), which led to the enactment of the *Superannuation Industry (Supervision) Act* and related legislation in 1993. Significantly, publicly offered superannuation products, that had been subject to the prescribed interest provisions of the Corporations Law as well as relevant superannuation legislation, were no longer subject to the Corporations Law.

ALRC/CASAC *Discussion Paper 59*, dealing with collective investments regulated under the prescribed interest provisions of the Corporations Law, was released in 1992, and the final Report No 65, entitled *Collective Investments: Other People's Money* and accompanied by draft legislation, in 1993. ALRC/CASAC concluded that the dual entity structure then mandated by statute resulted in a displacement of responsibility and was an inefficient structure to promote compliance. Their key recommendations for reform included:

- that the requirement to have a separate manager and trustee be abolished and replaced with a single, clearly identified entity responsible to investors and to public authorities for running the scheme
- that the responsible entity "have a clear set of obligations, prescribed by law, that it owes directly to the investors in the scheme. These would include the obligation to act honestly in all matters concerning the scheme and to prefer the interests of the investors to its own interests in all matters concerning the scheme"[4]

4. ALRC/CASAC *Report No 65* Summary, para 11.

- that the responsible entity have a majority independent board, owing clear obligations to investors
- that good compliance practices be ensured, through making a compliance plan a condition of a licence and a defence to liability for breach of duty
- that the regulator be given enhanced surveillance powers, and that auditors be required to report on breaches of the Corporations Law, the scheme constitution or the compliance plan
- that the requirement for an approved deed containing prescribed covenants be replaced with the requirement to have an enforceable constitution, the provisions of which were not inconsistent with the statute
- that disclosure requirements be expanded
- that scheme operators be subject to minimum capital requirements
- that mandatory buy-back be abolished
- that investors' access to remedies, particularly for oppression, be expanded, and
- that investors have the right to replace the operator of the scheme, to wind up the scheme, and to amend its constitution.

Following receipt of *Report No 65*, the Attorney-General's Department released a Draft Bill and Commentary in December 1995. The 1995 Bill adopted the Report's recommendation for a single responsible entity but in a number of respects departed substantially from the approach taken by ALRC/CASAC. In particular, the requirement for a majority independent board was removed, along with the proposed oppression remedy and members' statutory rights to take action against directors of the responsible entity and others involved in a contravention of the Law. The compliance plan was made a source of legal obligations, rather than a condition of obtaining a licence or a defence to liability. The concepts of the compliance committee and of separate auditors of the compliance plan were introduced. The capital adequacy requirements were removed, and the requirement for an external custodian introduced.

The 1995 Bill was due to be introduced into Federal Parliament early in 1996. However a Federal election was called for March 1996 and the legislation went into abeyance. Following the resulting change in Government a number of the policy issues addressed in the 1995 Bill, including the proposal to abolish the requirement for a separate trustee, were re-opened. The ongoing debate delayed parliamentary consideration of the bill. However in April 1997 the final report of the Financial System Inquiry recommended that the structure of collective investments be brought into line with that for superannuation funds, by introducing a requirement for a single responsible entity.[5]

In August 1997 the Treasurer announced major reform to the prescribed interest provisions of the Corporations Law. Legislation in substantially the same form as the 1995 Bill, but without the requirement for a separate custodian, was introduced into the Parliament in December 1997 and passed by the House of Representatives on 4 March 1998. The legislation was then referred to the Joint Committee on Corporations and Securities, which late in March 1998 recommended that it be passed in its current form. It was passed by the

5. FSI Final Report, Recommendation 89.

Senate with some amendments on 23 June 1998, and the amendments (including reinstatement of the capital adequacy requirements for responsible entities) adopted by the House of Representatives on 26 June 1998. Further changes to the regime were made by the promulgation of regulations on 30 June 1998.

Overview

The key elements of the regulatory scheme established by Chapter 5C are as follows:

- ***Registration:*** Schemes that fall within the definition of managed investment scheme and that have issued interests in circumstances requiring a prospectus must be registered with ASIC in accordance with Part 5C.1 of the Law, unless the scheme (or a group of related schemes) has less than 20 members and is not promoted by a professional promoter. To obtain registration:
  - ***Responsible entity:*** The scheme must have a responsible entity that is a public company and that holds a dealers licence authorising it to operate the scheme. Where it holds scheme property, and possibly in all cases, the responsible entity is a trustee for members.
  - ***Constitution:*** The scheme must have a legally binding constitution that deals with the matters prescribed by the legislation.
  - ***Compliance plan:*** The scheme must have a compliance plan that deals with the matters prescribed by the legislation.

Operating an unregistered scheme (where registration is required) is a contravention of sec 601ED(5), and a contract to acquire interests in such a scheme is voidable at the option of the acquirer under sec 601MB.

The remaining provisions of Chapter 5C go on to regulate the operation of registered schemes. The key requirements include:

- ***Statutory duties***: The responsible entity, its officers and any compliance committee members are subject to statutory duties of honesty, care and loyalty in the conduct of the scheme. In addition the responsible entity and its officers are subject to express statutory obligations governing the operation of the scheme. Employees of the responsible entity are subject to statutory duties of loyalty.
- ***Members' voting rights:*** Members have the right to remove and replace the responsible entity, veto changes to the constitution (other than changes that the responsible entity reasonably considers will not adversely affect members' rights), veto certain financial benefits to the responsible entity, its controlled entities or agents or their respective related parties out of scheme property, and direct the responsible entity to wind up the scheme.
- ***Compliance monitoring:*** An auditor must be appointed to audit compliance with the compliance plan annually. Unless the responsible entity has a majority independent board, a compliance committee must be established to monitor compliance with the compliance plan.

ASIC has the power to modify the operation of, or grant exemptions from compliance with, Chapter 5C, and has exercised this power extensively.

Responsible entities are subject to other statutory obligations in the conduct of registered schemes that are not contained in Chapter 5C. These include obligations:

- attaching to its securities dealers licence — Part 7.3
- relating to members' meetings — Part 2G.4
- to maintain a register of members — sec 167A
- to appoint an auditor for the scheme, and have the scheme accounts audited — sec 331AB
- relating to financial records and reporting — Chapter 2M
- relating to annual returns — Chapter 2N
- under securities regulation and continuous disclosure law — Parts 7.11 and 7.12
- to allow members access to scheme books — sec 247A
- on the responsible entities of listed schemes, to comply with the ASX Listing Rules — sec 777(3)
- on the directors of responsible entities of listed schemes, to disclose to ASX their interest in the scheme — sec 235.

Securities regulation and managed investment schemes

Interests in managed investment schemes (whether required to be registered or not) are "securities" for the purposes of Chapter 7 of the Corporations Law.

Section 92(1) includes, in the definition of securities, "interests in a managed investment scheme". Interests in a managed investment scheme made available by a body corporate are securities of that body by operation of sec 92(2).[6]

The expression "interest" where used in this context is broadly defined in sec 9. It means "a right to benefits produced by the scheme (whether the right is actual, prospective or contingent and whether it is enforceable or not)". The definition of interest is discussed in Chapter 2 below.

Because an interest in a managed investment scheme is a security, Chapter 7 of the Corporations Law applies. It is beyond the scope of this book to examine the securities laws in any detail in their application to interests in managed investment schemes.[7] However it must always be remembered, that, because they are securities:

- restrictions apply to conducting a market in them under Part 7.2[8]

6. Although the expression is not defined, in the ordinary course the person making available the interests will be the responsible entity of the scheme (or, where the scheme is unregistered, its operator). Section 92 of the old Law provided that prescribed interests made available by a body corporate were securities of the body. The definition of "management company" in the old Law was "... the body corporate by or on behalf of which the prescribed interests have been or are proposed to be made available..." Therefore prescribed interests were treated as securities of the management company. A similar approach under the new Law would suggest that the interests should be treated as securities of the responsible entity.
7. See generally Baxt, Black and Hanrahan.
8. Section 767 prohibits the conduct of unauthorised stock markets. The definition of "stock market" in sec 9 would include a market, exchange or other place at which, or a facility by means of which, offers to sell, purchase or exchange interests are made. Note that, under sec 770A, a responsible entity can make application for approval to set up a secondary market in interests and under sec 771 others can apply to establish an exempt stock market.

- persons who carry on a business of dealing in interests must be licensed under Part 7.3[9]
- persons who give investment advice in relation to interests must be licensed under Part 7.3[10]
- restrictions on short-selling and other dealings by licensees, and rules relating to recommendations by licensees, apply under Part 7.4
- certain conduct in relation to interests (including engaging in misleading or deceptive conduct in connection with dealings in interests) is prohibited under Division 2 of Part 7.11[11]
- the continuous disclosure rules may apply under Division 2 of Part 7.11[12]
- insider trading with respect to interests is prohibited under Division 2A of Part 7.11
- a prospectus may be required for the offer or issue of interests under Division 2 of Part 7.12[13]
- certain disclosure requirements may apply to secondary trading in unquoted interests under Division 3A of Part 7.12
- restrictions on hawking interests apply under Division 6 of Part 7.12,[14] and
- the rules relating to title and transfer of securities in Part 7.13 apply.

ASIC has modified the securities laws as they apply to managed investment schemes in a number of respects.

Interests in managed investment schemes are securities *whether or not* the schemes themselves are schemes requiring registration under Chapter 5C of the Corporations Law. However there is a considerable degree of overlap between the registration and prospectus requirements — generally a scheme will require both registration under Chapter 5C and a prospectus, or neither. The relationship between the prospectus and registration requirements is discussed in Chapter 2 below.

Finally, it should be noted that superannuation funds, approved deposit funds and pooled superannuation trusts are expressly excluded from the definition of managed investment scheme for most purposes.[15] However sec 92(1)(ca) provides that interests in these superannuation products are securities for the purposes of Parts 7.3 to 7.6 inclusive. This means that the licensing and conduct of business provisions apply in relation to them.[16]

9. See sec 780 and sec 93.
10. See sec 781 and sec 77.
11. Division 2 includes restrictions on market manipulation, fraudulent inducements to deal, and so on.
12. If interests in the scheme are "ED securities", the continuous disclosure provisions apply. "ED securities" is defined in Part 1.2A. Speaking very generally, schemes that are listed, or that are unlisted and have more than 100 members, may be subject to the continuous disclosure requirements in sec 1001A — 1001D, requiring them to disclose certain price sensitive information as soon as practicable.
13. The requirement to have a prospectus arises under sec 1018 (and, in the case of issue and on-sale, sec 1030). The content of the prospectus is prescribed by sec 1021 and 1022 as modified by reg 7.12.11 and 7.12.12 of the Corporations Regulations. A prospectus is not required in relation to an "excluded offer" of interests within the meaning of sec 66. The categories of excluded offer are discussed in Chapter 2 below.
14. Section 1078 prohibits a person from going from place to place or communicating by post, telephone or similar service offering interests for subscription or purchase. The section is designed to protect consumers against door-to-door canvassing and other like conduct.
15. See para (h) of the definition of "managed investment scheme" in sec 9.
16. ASIC Policy Statement 130.19 and ASIC Policy Statement 123.

Structure of this book

This book is divided into 10 chapters. Chapter 2 deals with the scope of regulation, through an examination of the definition of managed investment scheme and the parameters of the registration requirement. Chapter 3 discusses the requirements to establish a scheme, including the licensing process, the prescribed contents for the scheme constitution and compliance plan, the requirement to appoint a compliance plan auditor and a compliance committee, and the process of registration itself. Chapter 4 summarises the ongoing administrative requirements for registered schemes, including disclosure requirements, the requirement for annual returns, and the requirement to maintain registers. Chapter 4 also deals with changes to the structure of the scheme over its life, including changes of responsible entity and auditors, and amendments to the constitution.

Chapter 5 deals with the role and duties of the responsible entity, and the restrictions on related party transactions. Chapter 6 looks at the role of the compliance plan auditor and the compliance committee. Chapter 7 examines the position of the officers and employees of the responsible entity, and of compliance committee members.

Chapter 8 reviews the principal rights of scheme members, including their voting rights, withdrawal rights and enforcement rights. Included in this chapter is a discussion of the responsible entity's power (or duty) to take enforcement action on behalf of scheme members. Chapter 9 examines the role and powers of ASIC in relation to registered schemes, including its powers to modify the operation of Chapter 5C and its information gathering and enforcement powers.

The book concludes, in Chapter 10, with a discussion of deregistration and winding up of schemes.

The law as stated is that in force as at 1 November 1998.

Chapter 2

Scope of Regulation

Unlike corporations, managed investment schemes are not created by the process of registration. The registration requirement exists as an investor protection mechanism, by providing that certain investment schemes must be registered with ASIC. These schemes, once registered, become subject to various structural and operational requirements contained in Chapter 5C and other applicable provisions of the Corporations Law. An investment scheme is required to be registered if it is a managed investment scheme to which Chapter 5C applies, and registration is required under sec 601ED.

The scope of regulation, therefore, is determined by the following:

- Is the scheme a "managed investment scheme"?
- Is it a managed investment scheme to which Chapter 5C applies?
- Is registration of the scheme required under sec 601ED?

Definition of managed investment scheme: sec 9

Chapter 5C requires the registration of certain investment arrangements that come within the definition of managed investment scheme. In a functional sense the definition of managed investment scheme replaces the definition of prescribed interest that appeared in the old Law. Managed investment scheme is defined in sec 9 to mean:

> (a) a scheme that has the following features:
>
> (i) people contribute money or money's worth as consideration to acquire rights (*interests*) to benefits produced by the scheme (whether the rights are actual, prospective or contingent and whether they are enforceable or not)
>
> (ii) any of the contributions are to be pooled, or used in a common enterprise, to produce financial benefits, or benefits consisting of rights or interests in property, for the people (the *members*) who hold interests in the scheme (whether as contributors to the scheme or as people who have acquired interests from holders)
>
> (iii) the members do not have day-to-day control over the operation of the scheme (whether or not they have the right to be consulted or to give directions), or
>
> (b) a time-sharing scheme.

There are a number of specific exclusions set out in paragraphs (c) to (n) of the definition, that are discussed below.

Paragraph (a) schemes: sec 9

History

Paragraph (a) is in substantially different terms from the definition of participation interest, which is that part of the definition of prescribed interest in the predecessor legislation to which it can be seen to correspond functionally. However there is little in the relevant extrinsic material to suggest that, in altering the central definition, the intention was to alter significantly the reach of the operative provisions of the law, although possibly its scope is different.

The Explanatory Memorandum states that "the complex and seemingly all embracing definition of 'prescribed interest' has been widely criticised because of its lack of precision. The definition of 'managed investment scheme'... will provide greater certainty and guidance as to what investment arrangements are to be regulated under the Law".[1] This suggests that the intention was to clarify, rather than limit, the key definitions, an approach endorsed by Alan Cameron, Chairman of ASIC, shortly after the commencement of the legislation.[2]

As part of the collective investments review, ALRC/CASAC sought submissions on a proposal to replace the complex and multi-layered definition of prescribed interest with a simpler definition, linked to features such as:

- pooling of resources by investors
- an absence of day to day control of the management of the scheme by investors, and
- investors having the right to redeem their investments.[3]

However in its *Report No 65,* ALRC/CASAC recommended against this approach, concluding that "it is not possible to replace the existing definition of 'prescribed interest' with a more precise definition . . . which applies to fund raising schemes other than those which are prudentially supervised or schemes in which the investors themselves are primarily responsible for the conduct of the scheme".[4] The introduction of the new definition having some of the characteristics canvassed in *Discussion Paper 53* is therefore against the final recommendation of ALRC/CASAC.

Interpretation

In construing the definition of prescribed interest under the previous law, courts consistently took a broad view of the scope of the definition. In *Australian Softwood Forests Pty Ltd* v *Attorney-General for NSW* Mason J observed that:

> There is no very good reason for reading the words down. The context is that of prohibitions against issuing or offering to the public for subscription or purchase or inviting the public to subscribe for or purchase "interests" unless there is in force in relation to them an approved deed and unless there is provided information similar to that which is prescribed in connexion with an offer to the public of shares . . .

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1. Explanatory Memorandum, para 19.4–19.5.
2. Alan Cameron expressed the view that "it was not necessarily intended that the new Law would cover a wider range of schemes but rather provide more certainty of what is a managed investment": Alan Cameron "ASIC — The New Regulator meets the New Managed Investments Regime" Keynote Address, Compliance in Managed Investments, Sydney 21 July 1998.
3. ALRC/CASAC *Discussion Paper 53*, para 3.37–3.40.
4. ALRC/CASAC *Report No 65,* para 3.5.

> That a very wide meaning should be given to "interest" is attested by the exclusion from the statutory definition of shares and debentures, interests in life insurance policies, and, subject to some qualifications, interests in partnership agreements. The presence of the power to exempt by regulation other rights or interests from the definition is also of telling significance.[5]

Therefore His Honour took the view that the definition of prescribed interests should be read broadly because of its investor protection context and of the nature and scope of the exemptions from it. Both of these considerations continue to apply in relation to the definition of managed investment scheme in the context in which it is used in the Corporations Law.

The Australian Softwood Forests case suggests that a broad approach should be taken to interpreting the definition. In *R* v *Commons* Macrossan J observed that:

> It can be misleading to endeavour to form an accurate impression of the full scope of the intended statutory coverage by looking too single mindedly at the precise details of the particular schemes which the limited number of court decisions to date have indicated are caught. While analogy can be illuminating, there is a danger that the decisions which are, after all, mere examples, can induce the observer to believe that they define the limits of the scope of the definition. While certain points of principle may emerge from the decisions upon particular schemes, it is the broad words of the statute which must be returned to and, with respect, it is the deliminations of the correct approach which has been settled for us in *Wade* v *A Home Away Pty Ltd*[6] and, authoritatively for us, *Australian Softwood Forests Pty Ltd* v *Attorney-General for NSW*[7] which is of the greatest utility, together with the pronouncements of principle in the latter case.[8]

It seems unlikely that the definition can be read down on the basis that the legislation could not have intended to catch and proscribe a given transaction, even having regard to sec 109H and 109J.[9]

Although the words of the definitions of participation interest and managed investment scheme are very different, some of the flavour of the previous definition may have been carried forward into the new law, and commentary on the definition of participation interest may remain relevant in interpreting the new definition.[10]

The following discussion suggests that the definition of managed investment scheme is a difficult one to interpret, particularly to the extent that it applies to schemes that are not structured as unit trusts. It will remain for the courts to determine its scope.

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5. (1981) CLC ¶30–734.
6. (1980) CLC ¶40–669.
7. (1981) CLC ¶30–734.
8. (1986) 4 ACLC 551, 554.
9. *Carragreen Currency Corporation Pty Ltd* v *Corporate Affairs Commission (NSW)* (1986) 11 ACLR 298 at 316–7, per Hodgson J.
10. The Companies and Securities Law Review Committee (*CSLRC*) reviewed the definition of "prescribed interests" at some length in its *Report to the Ministerial Council: Prescribed Interests* (August 1988), para 20.6-20.7, 46–47 and its observations about the complexity of the predecessor definitions, together with Donald Magarey's commentary "Prescribed Interests" (1989) 9 *Company and Securities Law Journal* 25, are useful in interpreting several of the key concepts that have been carried forward into the new law. See also Robert Hughes *The Law of Public Unit Trusts* (1992), Chapter 2.

Elements of the definition

In order to fall within paragraph (a) of the definition there must be:

- a scheme
  - — to which people contribute money or money's worth as consideration
  - — to acquire rights (whether actual, prospective or contingent)
  - — to benefits produced by the scheme
- involving pooling of any of the contributions, or use of any of the contributions in a common enterprise
  - — to produce financial benefits, or to produce benefits consisting of rights or interests in property
  - — for contributors or people who have acquired interests in the secondary market
- in which the members do not have day-to-day control over the operation of the scheme.

The elements of the definition are discussed below.

'Scheme'

As a necessary precondition to the existence of a managed investment scheme, there must be a 'scheme'. In the context of the definition of participation interest it has been held that "all that the word 'scheme' requires is that there should be some programme, or plan of action".[11]

The scheme itself may consist of a number of separate components or parts, and a number of separate arrangements with different parties. In *ASC* v *Su*,[12] a promoter developed an investment scheme concerning the manufacture of potato cups. Interests were offered in separate trusts to separate investors. The South Australian Full Court determined that, despite the fact that separate trusts were used for each investor, the overall strategy developed by the promoter should be viewed as a single scheme. This would suggest that the commercial reality of the arrangement, rather than its legal form, is of the most significance.

To which people contribute money or money's worth as consideration to acquire rights to benefits produced by the scheme (whether the rights are actual, prospective or contingent and whether enforceable or not)

This element of the definition is said by the Explanatory Memorandum to "incorporate a purposive element in the definition". The word 'contribute' is used in the definition — arguably it is wider than 'invest'. Non-cash contributions must be money's worth that is

11. *Australian Softwood Forests Pty Ltd* v *Attorney-General for NSW* (1981) CLC ¶ 30–734 per Mason J, following *Clowes* v *Federal Commissioner of Taxation* (1954) 91 CLR 209.

12. (1995) 13 ACLC 770.

recognised consideration in the law of contract (therefore, past consideration is no consideration).[13]

The rights acquired may be actual, prospective or contingent, and may be enforceable or unenforceable. In this respect the definition mirrors the earlier definition of participation interests, and therefore it is sufficient for the contributor to have some expectation of an interest or equitable interest in the enterprise.[14] The definition of "interest in a managed investment scheme" included in sec 9 mirrors this broad approach: it refers to "a right to benefits produced by the scheme (whether the right is actual, prospective or contingent and whether it is enforceable or not)".

As was the case with the definition of participation interest there are obvious tensions between the concept of a 'right' and something that is unenforceable. This was avoided in some degree in the definition of participation interest, because it used the expressions 'right or interest' in the alternative in this context (if it is easier to conceive of an unenforceable interest that an unenforceable right). The use of the word 'acquire' in the definition (which did not appear in definition of participation interest) may add further complexity, if the courts are asked to consider whether a person has acquired an unenforceable, prospective right.

It is arguable that the benefits to which the contributors acquire rights under the scheme need not be financial or proprietary in nature, although subparagraph (ii) of the definition requires that the scheme itself be one in which contributions are to be used to produce financial or proprietary benefits for the members. Given that the effect of subparagraph (ii) is to exclude from the definition schemes in which there is no intention to use scheme assets to produce a financial or proprietary benefit, the fact that benefits is used without qualification in subparagraph (i) may not be significant.

Given that managed investment schemes are not (or at least in the vast majority of cases are not) themselves legal entities, the reference to benefits "produced by the scheme" is unclear. This may be particularly significant where the benefits are to be produced by the promoter or some third party, without any involvement by the other participants in the scheme. It is possible that, adopting a purposive approach to interpretation, courts would interpret this phrase as 'produced in accordance with, or on the terms of, or through the realisation of, the scheme', or something similar.

'Contribute'

The use of the word 'contribute' in paragraph (i) of the definition may be of considerable significance in interpreting its scope, particular in circumstances were scheme assets are held by the investor.

Contribute is defined in the *Concise Oxford* as "pay or furnish (to common fund etc), pay or give jointly with others". Arguably it connotes some form of association, requiring more than one payer or contributor. If so, it is arguably that only schemes that involve pool-

13. See eg *Bury* v *Famatina Development Corp Ltd* [1909] 1 Ch 754 for the discussion of non-cash consideration in relation to the issue of shares.

14. See eg *CAC* v *Australian Softwood Forests Pty Ltd* (1978) 1 NSWLR 150.

ing or use of the property in an enterprise that is common to more than one investor come within the definition. The payment of money or money's worth to acquire an interest in a scheme would appear to be a 'payment' and not a 'contribution' unless more than one contributor or payer is contemplated.

'As consideration'

The money or money's worth contributed must be contributed *as consideration to acquire rights* to benefits produced by the scheme. In the case of schemes structured as unit trusts, this characteristic would appear to be present. The investor separates from their personal estate and pays to the responsible entity or its agent money or money's worth and in return acquires a unit in the trust which represents a beneficial interest in the trust property and any accretions to it. To the extent that it confers a right to share in accretions to the trust property resulting from the management of that property by the responsible entity, the unit may be seen as embodying a right to receive benefits produced by (or at least pursuant to) the scheme.

But the situation may be less clear where the structure of the scheme is different. Some small scale agricultural and real estate schemes are structured so that the investor acquires an asset (a bird, a tree plantation, or a strata title apartment) which is then managed by the promoter/vendor, or an associated company. In such a case it would appear appropriate, in light of cases such as *Australian Softwood Forests* and *ASC* v *Su* discussed above, to view the separate components of the transaction (acquisition and management) as a single scheme.

Is there a contribution to acquire rights to benefits produced by the scheme? The money contributed will generally be the purchase price of the asset, and periodic payments to the manager (either in the form of payments by the investor or withholding by the manager of part of the income generated by the project). If the initial contribution, viewed as a matter of substance and not form, confers on the investor an interest in the property and a right to enter into the management arrangement, then to the extent that income is a benefit produced by the scheme to which the investor has a right (under the terms of the management agreement or because of their proprietary interest in the assets) the arrangement would appear to be caught.

Contrast this with the situation where a person sells assets, or provides management services, but the two arrangements are so separate that they could not possibly be viewed as part of a single scheme. Examples would include:

- where a breeder sells animals and the purchaser, both legally and commercially, is free to manage the animal without the ongoing involvement of another person
- where a property developer sells property and the purchaser, both legally and commercially, is able to use and enjoy the property without the ongoing involvement of another person, or
- where a managing agent agrees to provide management services in respect of any asset, however and from whomever acquired (eg a real estate agent providing property management services as a landlord's agent).

In the first two cases, the amount contributed (the purchase price) was not consideration for the acquisition of rights in a scheme, but consideration for the acquisition of assets from another person. In the third case, the ongoing management fees are consideration for management services provided, not for benefits produced by a scheme.

Subparagraph (ii) of the definition requires that "any of the contributions are to be pooled, or used in a common enterprise, to produce" benefits. This requirement that the contributions be utilised in the scheme is discussed below.

Involving pooling or a common enterprise

Subparagraph (ii) limits the definition to schemes in which "any of the contributions are to be pooled, or used in a common enterprise, to produce . . . benefits".

Where a person has contributed money or money's worth to a trust, that contribution will form part of the corpus of the trust and will be used (invested) by the trustee to produce benefits (investment income) that will accrue to the trust and in which beneficiaries will have an interest. Such schemes involve both pooling of assets (in the hands of the responsible entity or its agent) and use in an enterprise common to the members and the responsible entity.

In the case of scheme involving the sale and management of assets (such as agricultural and real estate schemes) where the investor retains title to the asset, it may be more difficult to establish whether pooling of contributions, or the use of contributions in a common enterprise, has occurred.

The sub-paragraph requires that the contribution "be pooled, or used in a common enterprise". Those requirements are cast in the alternative.

Under the former Division 5 of Part 7.12 of the Corporations Law, schemes that did not involve pooling of assets or contributions, or the use of assets or contributions of one investor in common with the assets or contributions of another investor, were nevertheless treated as prescribed interest schemes in certain circumstances. ASC Policy Statement 55, as in force on 30 June 1998, referred in paragraphs 37 and 38 to schemes in which "money and property are not pooled or available for use in common under the scheme . . . An example of this is a scheme in which each prescribed interest is a particular title to land and the right to the management of that land."

Subparagraph (ii) is discussed in the Explanatory Memorandum in the following terms:

> Notably, the term 'used in a common enterprise' may include arrangements described as enterprise or agricultural schemes. The concept of a 'common enterprise' has been judicially considered on a number [of] occasions and continues to be relevant for the purposes of this definition. Since 'any of the contributions' are to be pooled, arrangements, such as those know as managed discretionary accounts or member discretionary master funds where part of the contributions made by a member to a scheme may not be pooled, will nonetheless fall within the definition.[15]

15. Explanatory Memorandum para 19.7.

'Pooled' is not defined, but appears to involve a concept of mixing or combining the contribution with contributions of others or of the operator of the scheme.

The case law on the meaning of common enterprise to which the Explanatory Memorandum refers has established the following principles:

- An enterprise may be described as "common" if it consists of two or more closely connected operations on the footing that one part is to be carried out by A and the other by B, each deriving a separate profit from what he does even though there is no pooling or sharing of receipts or profits. It will be enough that the two operations constituting the enterprise contribute to the overall purpose that unites them.[16]
- The common enterprise need not be an enterprise in common with other investors, but may be an enterprise common to the investor and the promoter.[17] It is not necessary for the enterprise to involve joint participation in all elements and activities that constitute the enterprise.

Much of the flavour of the Explanatory Memorandum and the various ASIC Policy Statements would appear to suggest that "use in a common enterprise" is to be interpreted as 'use in common with the contributions of other members'. However the meaning in *WA Pines Pty Ltd* v *Hamilton* is clearly much broader than that, extending to enterprises common only to the investor and the promoter.

The Explanatory Memorandum refers to managed discretionary accounts or member discretionary master funds where *part of the contributions* (emphasis added) made by a member to a scheme may not be pooled, as nevertheless falling within this limb of the definition. This raises the question of whether managed discretionary accounts or member discretionary master funds in which none of the contributions are pooled are caught by the definition. Similarly, a number of ASIC Policy Statements would appear to suggest that it takes the view that some degree of pooling, or use of members' contributions in common with the contributions of other members, is required.[18]

It may be that the use of the word 'contribute' in the definition necessarily implies that the contributions of more than one investor are utilised in the scheme, before the scheme is within the definition of managed investment scheme. However it remains clear that, on its face, the sub-paragraph treats the requirements for pooling and use in a common enterprise as alternatives.

To produce financial benefits, or benefits consisting of rights or interests in property, for the members

The fact that the benefits must be financial, or consist of rights or interests in property, would appear to exclude from the definition schemes that are intended to produce other benefits, such as social or professional ones.

16. *Australian Softwood Forests Pty Ltd* v *Attorney-General for NSW* (1981) CLC ¶ 30–734 per Mason J at p 33,286.
17. *WA Pines Pty Ltd* v *Hamilton* (1980) CLC ¶ 40–654.
18. See eg ASIC Policy Statement 134.40.

The contributions must be used to produce the relevant benefit "for the people (the members) who hold interests in the scheme (whether as contributors to the scheme or as people who have acquired interests from holders)". Arguably where benefits are directed to a third party, the scheme is not caught. If this interpretation is correct, charitable schemes such as those subject to ASC Policy Statement 87 as in force on 30 June 1998 would appear to be excluded, although ASIC has signalled its intention to continue to treat such schemes as falling within the regulatory net.[19]

The members do not have day to day control over the operation of the scheme

A scheme in which members have day-to-day control over its operation is not a managed investment scheme under the Law. The definition goes on to provide that the fact that the members have the right to be consulted or to give directions is not of itself sufficient to constitute day-to-day control over the operation of the scheme.

Reference to the members where used in this part of the definition may be ambiguous. If the expression "the members do not have" was interpreted to mean 'no member has', a scheme operator could defeat the section by issuing interests in the scheme to itself, thereby becoming a member having day to day control over the operation of the scheme. It therefore seems more likely that, in accordance with sec 109H, the reference to the members will be interpreted as meaning 'all the members'.

The concept of a person having "day-to-day control over the operation of the scheme" is central in applying the definition of managed investment scheme. The Explanatory Memorandum provides no guidance on its interpretation, but the comments of ALRC/CASAC in *Report No 65* suggest that their intention may have been to exclude from regulation those schemes that provide for investor participation. Examples given by ALRC/CASAC of schemes that "allow a greater degree of investor participation than is provided for investors in [managed] investment schemes" include joint venture schemes and partnerships (other than limited partnerships).[20] However the definition of managed investment scheme was not among ALRC/CASAC's recommendations so it may be difficult to extrapolate from the comments contained in its report.

Again, it will be left to the courts to determine the scope of this element of the definition. Read as a whole, subparagraph (iii) suggests that it may not be sufficient for the members to have a capacity to control, instead it may be that they must in fact exercise control (or at least have a genuine commercial expectation of control), before the scheme falls outside the definition.

The use of a control test can be contrasted with the concept of involvement in management, which is found in the law of limited partnership. Limited partners may lose their limited liability if they take part in the management of the partnership.[21] On its face a control test appears more stringent than a test of whether members take part in management—

19. ASIC Policy Statement 136.46.
20. ALRC/CASAC *Report No 65*, para 3.18.
21. See eg *Partnership Act 1992* (NSW) sec 67(1).

if this is correct then a scheme in which members take part in management may nevertheless be within the definition because those members do not exercise sufficient control to take the scheme outside it.

Where a scheme has only one member who is also its operator, it seems clear that it falls outside the definition of managed investment scheme. (Under the old Law, such schemes often required approval because other prescribed interest schemes invested in them, under former reg 7.12.15(1)(a) of the Corporations Regulations.) ASIC has noted that "we do not consider that controlled sub-trusts under [PS 55.118] onwards are schemes because the members, ie the responsible entity as trustee, have day-to-day control over the sub-trust".[22]

The situation becomes more complex where the scheme has more than one member, and those members are not related corporations. For example, say a property trust has two members and is managed by a joint venture company established by the members. This would appear to fall outside the definition. But what if this structure were used for a listed trust with thousands of members, through a device of stapling trust units to shares in the operator? It seems unlikely that, in such a structure, the members would be treated as collectively controlling the day-to-day operation of the scheme.

Therefore it is suggested that it is appropriate to look at the reality (or perhaps the expectation) of control, rather than the capacity to control. If the persons who are the members of the scheme are the persons making the actual day-to-day management decisions about its operations, the scheme will be outside the scope of subparagraph (iii). Otherwise, even if the members have the legal capacity to control decision making, the scheme will be caught.

It is interesting to note the application of this subparagraph in relation to general partnerships. In most cases, partners in a general partnership will take part in the management of the partnership business. However the drafter appears to have considered that general partnership could come within the definition of managed investment scheme, despite paragraph (a)(iii). Certain general partnerships are expressly excluded from the definition by paragraph (c) (see below), and the guidance note at the end of the definition states that "a partnership with less than 20 members will usually not require registration because of paragraph 601ED(1)(a)", suggesting that partnerships could require registration but for that exclusion.

Time share schemes: paragraph (b)

By operation of paragraph (b) of the definition, the definition of managed investment scheme includes time-sharing schemes. "Time-sharing scheme" is defined in sec 9 and means:

> a scheme, undertaking or enterprise, whether in Australia or elsewhere:
>
> (a) participants in which are, or may become, entitled to use, occupy or possess, for two or more periods during the period for which the scheme, undertaking or enterprise is to operate, property to which the scheme, undertaking or enterprise relates; and

22. ASIC Policy Statement 136.57.

(b) that is to operate for a period of not less than three years.

The definition of time-sharing scheme is derived from the corresponding definition first introduced into the *Companies Act 1981* and corresponding State and Territory Codes in 1985. Before that date, time-sharing schemes had not been expressly included in the definition of prescribed interest, although they had been held on occasion to come within its general terms.[23]

Inclusion of the definition of time-sharing scheme followed the decision in *Brentwood Village Ltd* v *CAC*.[24] In that case occupation rights were attached to company shares, and it held that, because the rights were indivisible from the shares, they fell within the specific exclusion from the definition of prescribed interest of company shares. The intention in enacting the definition of time-sharing scheme was to ensure that schemes structured in this way would nevertheless be subject to the prescribed interest provisions. This was done by providing that, while company shares were expressly excluded from the definition of participation interest, they were not excluded from the definition of time-sharing scheme. In this way it was possible for a share in a company to be an interest in a time-sharing scheme, and therefore a prescribed interest.

This position is preserved by the terms of paragraph (d) of the definition of managed investment scheme, which excludes bodies corporate other than those that operate as time sharing schemes.

ASC Policy Statement 66 deals extensively with time-sharing schemes. Examples of time-sharing schemes involving real property given by ASC (under the old Law) are:

- title-based schemes where a purchaser becomes a tenant in common with the right to a share of the real property
- company structured schemes, where the purchaser holds a share in the company that owns and runs the property (an exception to the general rule that if a scheme is a body corporate, then it is not a managed investment scheme)
- "right to use" schemes, where the purchaser acquires the right to occupy the scheme premises (under a lease, licence or share), and
- trust based schemes, where a property is acquired by the trustee and held on behalf of participants for a defined period.

A scheme in which participants purchased the right to a vacation for a fixed, discount price at an unidentified location, and that depended on the participant renewing his or her membership annually, has been taken to fall outside the definition of time-sharing scheme.[25]

Specific exclusions

The definition of managed investment scheme in sec 9 contains 11 express exclusions (paragraphs (c) to (m)) and a power to declare by regulation that further schemes are excluded (paragraph (n)). No regulations have yet been made under paragraph (n).

23. *A Home Away Pty Ltd & Ors* v *CCA* (1980) CLC ¶ 40–669.
24. (1983) 1 ACLC 1,006.
25. *Kerr* v *Visa Vacations Pty Ltd* (1986) 4 ACLC 614.

The express exclusions mirror many of the exclusions previously contained in the definition of participation interest and reg 7.12.04 of the Corporations Regulations. However it should be noted that the two definitions operate differently, and accordingly the structure of the exclusions is different. Under the old law, the defined term was the *interest* in the scheme, while under the new approach the definition seeks to describe the scheme itself.

The exceptions are:

- ***Partnerships with more than 20 partners.*** The definition excludes partnerships covered by an application order made for the purposes of sec 115. Section 115 is the section of the Corporations Law that prohibits outsize partnerships. The effect of the exclusion is to provide that lawful partnerships with more than 20 partners are not managed investment schemes. Its effect is somewhat anomalous. Its presence suggests that partnerships with less than 20 members are managed investment schemes (though in the majority of cases these small partnerships are schemes that do not require registration by operation of sec 601ED). However the question of whether a general partnership could ever constitute a managed investment scheme will depend, ultimately, on the view taken by the courts of the meaning of "day-to-day control of the operation of the scheme" in subparagraph (a)(iii) of the definition (see above).
- ***Bodies corporate:*** The definition excludes bodies corporate (other than bodies corporate that operate as time-sharing schemes). Bodies corporate operating as time-sharing schemes are discussed above.
- ***Intra-group schemes.*** Paragraph (e) excludes schemes in which all the members are bodies corporate that are related to each other and to the body corporate that promotes the scheme. For the definition of "related", see Division 6 of Part 1.2 of the Corporations Law.
- ***Franchises.*** "Franchise" is defined in sec 9 as "an arrangement under which a person earns profits or income by exploiting a right, conferred by the owner of the right, to use a trade mark or design or other intellectual property or the goodwill attached to it in connection with the supply of goods or services. An arrangement is not a franchise if the person engages the owner of the right, or an associate of the owner, to exploit the right on the person's behalf." A line of cases in the early 1980s had suggested that franchises have characteristics that bring them within paragraph (b) of the definition of participation interest until they were expressly excluded by regulation.[26] Although the exclusion of franchises from the scope of regulation reflects the former reg 7.1.02 of the Corporations Regulations, it should be noted that the new definition of "franchise" differs from that previously appearing in reg 1.02(1) of the Corporations Regulations.
- ***Statutory funds of life insurance companies.*** Paragraph (g) excludes statutory funds maintained under the *Life Insurance Act 1995* (Cth) from the definition of managed investment scheme. The predecessor legislation excluded "any interest in, or arising out of, a life policy within the meaning of the *Life Insurance Act 1995*" (see paragraph (f) of the definition of "participation interest").

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26. Donald Magarey "Prescribed Interests" (1989) 9 *Company and Securities Law Journal* 25, 30–2.

- ***Superannuation funds.*** Regulated superannuation funds, approved deposit funds, pooled superannuation trusts, and public sector superannuation schemes, as defined in *Superannuation Industry (Supervision) Act 1993* (Cth), are excluded from the definition. Prior to 1993, public offer superannuation funds had been subject to the prescribed interest provisions of the Corporations Law as well as relevant taxation legislation. However on the recommendation of ALRC/CASAC in *Report No 59* such schemes were taken outside the scope of the prescribed interest provisions by former reg 7.12.04(d). It should be noted that interests in superannuation schemes that would be managed investment schemes but for the operation of paragraph (h) are securities for the purpose of Parts 7.3 to 7.6 of the Corporations Law.[27]
- ***Banking operations.*** A scheme run by an Australian bank in the ordinary course of its banking business is also excluded. See also reg 5C.11.01 for the application of Chapter 5C to the activities of other financial institutions.
- ***Debenture and convertible note issues.*** The inclusion of this paragraph is consistent with a view that debentures and convertible notes do not represent interests in bodies corporate that would be excluded (along with shares) by paragraph (d) of the definition. The drafting of paragraph (j) may suggest that the issue of debentures or convertible notes itself, rather than body corporate against which they represent a claim, would otherwise be considered a scheme. Debentures issued by bodies corporate were excluded from the definition of participation interest by paragraph (e) of that definition.
- ***Barter schemes.*** Schemes under which each participant may obtain goods or services from another participant for consideration that is wholly or substantially in kind rather than in cash are excluded by paragraph (k).
- ***Retirement villages.*** Schemes under which a person is entitled to residential accommodation in a retirement village and that are not time-sharing schemes are excluded. Interests in retirement village schemes had been excluded from the definition of prescribed interest by former reg 7.12.04(a) of the Corporations Regulations.
- ***Exempt Western Australian schemes.*** Paragraph (m) preserves the exemption effectively provided to certain Western Australian cooperatives by the predecessor sec 68A of the Corporations Law. A scheme operated by a cooperative company registered under Part VI of the *Companies (Co-operative) Act 1943* of Western Australia is not a managed investment scheme under sec 9. The continued operation of sec 68A as amended is unclear: sec 68A had previously been relevant to paragraph (d) of the definition of prescribed interest in sec 9, which has now been repealed.

Schemes excluded from Chapter 5C

Regulation 5C.11.01, and certain instruments issued by ASIC, exclude certain schemes from the operation of Chapter 5C. These schemes are, nevertheless, managed investment schemes for all purposes (including sec 601FC and the provisions of the Corporations Law that apply to securities).

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27. Section 92(1)(ca) — see Chapter 1 above.

Regulation 5C.11.01

Regulation 5C.11.01 provides that Chapter 5C in its entirety does not apply to:

- the issue by a financial institution of withdrawable shares
- deposit taking by a financial institution
- something else done by a financial institution in the ordinary course of its banking business
- the provision by a special service provider of certain services mentioned in the AFIC Codes, or
- the issue of shares to a building society by a building society special services provider or to a credit union by a credit union special services provider.

Regulation 5C.11.01 should be read in conjunction with Part 1.2B of the Corporations Law and the AFIC Codes (as defined in that Part).

The location of and headings to this regulation suggest that it has been made under sec 601QB, which provides that:

> The regulations may modify the operation of this Chapter or any other provision of this Law relating to securities in relation to:
> (a) a managed investment scheme; or
> (b) all managed investment schemes of a specified class.

Section 601QB does not contain a power to grant exemptions, only modifications (c.f. ASIC's exemption and modification power under sec 601QA). However the regulation purports to be an exemption.[28]

If the intention was to ensure that these activities were not treated as managed investment schemes, then it would have been preferable to make a regulation under paragraph (n) of the definition of managed investment scheme, to exclude these activities from the definition of managed investment scheme. This would have ensured that the treatment, for example, of banking activities by Australian banks, and banking activities by financial institutions, was consistent. However this approach was not taken. Arguably the effect of reg 5C.11.01 is to deem the arrangements covered by it to be managed investment schemes. This is because sec 601QB only confers a power to make regulations with respect to managed investment schemes.

If these arrangements are treated as coming within the definition of managed investment schemes, although exempt from Chapter 5C, then two important consequences follow. Responsible entities of registered schemes will be preventing from investing in them unless they are registered under Chapter 5C.[29] In addition, interests in the arrangements will be securities for the purposes of the Corporations Law (although a prospectus will not be required for their issue, by operation of sec 66(2)(da)).

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28. See Chapter 9 below.
29. Section 601FC(4).

ASIC exemptions

ASIC has power under sec 601QA to grant exemptions from Chapter 5C. ASIC has indicated its intention, as did its predecessor, to relieve scheme operators from compliance with Chapter 5C where:

- there is an appropriate co-regulatory arrangement
- there is an appropriate alternative regulatory regime
- the schemes do not involve investments (eg interests not issued for money referred to in ASIC Policy Statement 80)
- the schemes are small scale private arrangements, or
- members of the schemes are in a position where they do not require regulatory protection.[30]

Of course, schemes that are small scale private arrangements will only require the relief if they are promoted by someone in the business of promoting similar schemes. Otherwise if the scheme (or a group of related schemes of which the scheme is a member) has less than 20 members, registration will not be required in any event (see below).

ASIC has granted exemptions from Chapter 5C (subject to compliance with the terms of the relevant instrument) in respect of a number of types of schemes, including the following:[31]

- horse racing syndicates (ASIC Class Order 98/65)
- charities and school enrolment deposits (ASIC Class Order 98/66 and 98/68)
- schemes operated by friendly societies (ASIC Class Order 98/69)
- private horse breeding schemes (ASIC Class Order 98/70 and 98/71)
- private ostrich schemes (ASIC Class Order 98/72)
- small property syndicates (ASIC Class Order 98/78)
- Lloyds syndicates (ASIC Class Order pending)
- film and show royalties (ASIC Class Order 98/74)
- film investment schemes (ASIC Class Order 98/75)
- interests issued not for money (ASIC Class Order 98/76).

Interim relief in respect of managed discretionary accounts operated by members of the Sydney Futures Exchange has been granted from sec 601ED(5), until 1 July 1999.[32] Participating property syndicates have also been granted interim relief from Chapter 5C until that date.[33]

Close attention must be paid to the scope of and conditions attaching to the relief in each case.

Where the Class Order exempts the operator from compliance with Chapter 5C, it is important to remember that interests in such schemes remain interests in managed

30. ASIC Policy Statement 136.43. See also Chapter 9 below.
31. ASIC Policy Statement 136.46.
32. ASIC Class Order 98/63.
33. ASIC Class Order 98/64.

investment schemes. Therefore they are securities for the purposes of the Corporations Law. Because the schemes are unregistered managed investment schemes, the 20 offers in 12 months exemption from the prospectus requirement does not apply in relation to them.[34] Therefore a prospectus may be required for offers of interests in these schemes, despite the fact that they are exempted from the registration requirement and notwithstanding sec 66(2)(da), unless ASIC has granted a separate exemption from the prospectus provisions or the offer is an excluded offer. Generally, an exemption from Part 7.12 will be granted together with the Chapter 5C relief.

Note too that dealings in these interests will be subject to the securities laws.

ASIC states that "if we exempt a person from Chapter 5C when operating a scheme, we do not consider that all offers and issues of interests in the scheme will be excluded offers and issues under sec 66(2)(da) and sec 66(3)(da). This is because the exemption does not affect whether sec 601ED requires a scheme to be registered. It merely exempts a person from liability for non-compliance with sec 601ED(5) if they operate an unregistered scheme that must be registered".[35] However this view may be open to challenge, and will ultimately depend on the proper construction of the relevant instrument of exemption.

Schemes requiring registration

If a scheme is a managed investment scheme and is not excluded from Chapter 5C by reg 5C.11.03 or ASIC class order, registration may be required by sec 601ED.

In general terms, sec 601ED requires the registration of all schemes (other than small, private schemes) that have offered interests in circumstances requiring a prospectus. In addition, as a practical matter, some schemes that conduct only excluded issues may also need to be registered, if their members are to include other registered schemes.[36]

The registration requirement: sec 601ED(1)

Section 601ED(1) provides that:

> Subject to subsection (2), a managed investment scheme must be registered under sec 601EB if:
> (a) it has more than 20 members; or
> (b) it was promoted by a person, or an associate of a person, who was, when the scheme was promoted, in the business of promoting managed investment schemes; or
> (c) a determination under subsection (3) is in force in relation to the scheme and the total number of members of all of the schemes to which the determination relates exceeds 20.

Subsection 601ED(2) goes on to limit the registration requirement, providing that "a managed investment scheme does not have to be registered if all the issues of interests in the scheme that have been made were excluded issues (disregarding paragraph 66(2)(da)) when they were made".

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34. Sections 66(2)(d) and 66(3)(d).
35. ASIC Policy Statement 136.47.
36. Section 601FC(4).

More than 20 members

The exclusion from regulation of schemes with 20 or less members (unless paragraph (b) or (c) applies) represents a significant departure from the old Law. Under the prescribed interest provisions of the Corporations Law, small schemes were for the most part subject to regulation unless they fell within the specific exemptions for joint ventures with less than 15 venturers or private trusts with less than 15 beneficiaries, previously contained in reg 7.12.04 of the Corporations Regulations. This was reflected in the former sec 66, under which an exemption from the prospectus requirements for share and debenture issues involving less than 20 offers in a 12 month period did not extend to issues of prescribed interests.[37]

Section 601ED(1)(a) therefore reverses the previous position, and assumes that most small scale schemes will not require registration (and therefore will not be subject to the legislative requirements applying to registered schemes).

For the purposes of calculating how many members a scheme has, joint holders of interests are counted as a single member, and interests held on trust are treated as being held by the beneficiaries, rather than the trustee, where the beneficiaries are presently entitled to a share of the trust estate or the income of the trust estate, or are in a position to control the trustee.[38] However if the operator of a scheme did not know, and had no reason to suspect, that an interest was held on trust for multiple beneficiaries, and therefore operated the scheme without being aware that registration was required, the operator does not breach the registration requirement.[39]

The scheme to which the section refers is the overall plan or programme of action, rather than the particular legal structure in which each member participates. Therefore a scheme can consist of a number of, say, separate trusts, with each trust having only one or a few beneficiaries. In *ASC* v *Su*[40] (see above), the court found that a person who promoted three trusts dealing with potato chip cup manufacturing equipment was engaged in one enterprise, rather than three. In reaching his conclusion, Olsson J (with whom King CJ and Mohr J agreed) took the view that the overall strategy the promoter had developed was a single programme or plan of action and thus a single scheme. In this situation, the number of participants in the scheme would be calculated by adding together the number of beneficiaries in each of the three trusts.

Schemes with more than 20 members require registration unless all issues of interests in the scheme that have been made were excluded issues when they were made.[41]

37. Former sec 66(2)(d) and 66(3)(d).
38. Section 601ED(4).
39. Section 601ED(7).
40. (1995) 13 ACLC 770.
41. Section 601ED(2).

Promoted by a professional promoter

Section 601EB(1)(b) provides that a scheme must be registered, even if it has 20 or fewer members, if it "was promoted by a person, or an associate of a person, who was, when the scheme was promoted, in the business of promoting managed investment schemes".

Under the previous law, small scale partnerships, joint ventures and private trusts had largely been excluded from regulation unless they were "promoted by or on behalf of a person, or an associate of a person, whose ordinary business is or includes the promotion of similar schemes".[42] The new provision differs from the old, and those differences may be significant. The expression "whose ordinary business is or includes" has been replaced with "who was in the business of": it is not clear whether a different meaning is intended. The reference to "similar schemes" has been replaced with "managed investment schemes", so there is no longer a requirement that the schemes be similar in subject matter or structure. Also, the relevant time at which the person's business must be examined is fixed at the time the scheme in question was promoted.

The Federal Court was asked to consider the former paragraph (g)(i) of the sec 9 definition of participation interest in *ASC* v *Woods and Johnson Developments Pty Ltd & Anor*.[43] The issue before the Court was whether an horticultural project promoted by the respondent was one "promoted by or on behalf of a person whose ordinary business is or includes the promotion of similar [schemes]". The ASC's case was that the first respondent had become the promoter of one other project (the crayfish project) similar to the horticultural project. The first respondent's evidence was that it undertook the capital works of the crayfish project and was also the production manager.

Relevantly, Pincus J held:

- The business must involve the promotion of more than one scheme. Sec 109R (the plural includes the singular) is excluded by the context in which the word "schemes" is used. Therefore the fact that a person is in the business of promoting a single scheme is not sufficient.
- However the section can catch the promotion of the first of what is to be a series of schemes. "The promotion of a single project may be enough to enable the applicant to succeed in a case of this kind, but only if that undertaking is the first in a business of promoting similar undertakings".[44]
- Promoter in this context means a person who engages in exertion for the purpose of, or assists in, getting up and starting the scheme.[45] The definition of promoter in sec 9, that applies "in relation to a prospectus", is not relevant. The respondent's activities in relation to the crayfish project did not constitute promotion.

42. See former para (g)(i) of the definition of "participation interest", and former reg 7.12.04(b)(iii) and (c)(i).
43. (1991) 9 ACLC 1,492.
44. Ibid 1496.
45. Ibid 1,495, following *Tracy & Ors* v *Mandalay Pty Ltd* (1952–3) 88 CLR 215.

Related schemes with more than 20 members

Section 601ED(1)(c) provides that a scheme must be registered if "a determination under subsection (3) is in force in relation to the scheme and the total number of members of all the schemes to which the determination relates exceeds 20".

ASIC has power under subsection (3) to determine, in writing, that "a number of managed investment schemes are closely related and that each of them has to be registered at any time when the total number of members of all the schemes exceeds 20." ASIC is required to give written notice of the determination to the operator of each scheme.

The Explanatory Memorandum suggests that the purpose of giving ASIC this power was to overcome the difficulties raised by *ASC* v *Su* (see above), but this approach appears to misunderstand the Court's decision in that case (that the separate trusts should be treated as one scheme).[46]

ASIC treats sec 601ED(3) as an anti avoidance provision "to prevent promoters avoiding the registration requirement by structuring their offerings as separate schemes each having less than 20 members but which in aggregate have more than 20 members. It also provides a way . . . to prevent promoters from relying inappropriately on the 20 offers in 12 months exclusion by calculating the 20 offers separately for each separate but related scheme".[47]

ASIC's policy in applying sec 601ED(3) is set out in ASIC Policy Statement 136.82. ASIC applies the section where schemes are promoted by different people but the circumstances indicate that the promoters are likely to be associated, where there appears to be a systematic promotion but there is doubt about whether the scheme falls within sec 601ED(1)(a) or (b), or where the schemes are so similar that they could be sold under the one prospectus.

ASIC's power under sec 601ED(3) is not insignificant. Under the previous law, the regulator was required to apply to the Court (generally under sec 1324 or sec 1114) for orders that conduct constituted the conduct of a prescribed interest scheme subject to regulation under Division 5 of Part 7.12 of the Corporations Law. (*ASC* v *Su* is an example of such an application.) Section 601ED(3) largely circumvents that process. ASIC's decision making under sec 601ED(3) may be subject to review under normal administrative law procedures.

Registration not required for excluded issues: sec 601ED(2)

Strictly speaking, schemes that have made only excluded issues of units (disregarding sec 66(2)(da)) are not required to be registered. Section 601ED(2) overrides the registration requirement in sec 601ED(1). Therefore, even if a managed investment scheme:

- has more than 20 members, or
- is promoted by a professional promoter, or
- is the subject of a declaration under sec 601ED(3),

46. Explanatory Memorandum para 7.6.
47. ASIC Policy Statement 136.84.

it is not required to be registered if all the issues of interests in the scheme that have been made were excluded issues (disregarding paragraph 66(2)(da)) when they were made.

ASIC has granted relief to exclude the registration requirement for schemes in which all current members were issued their interests by excluded issue, even though former members may have taken a non-excluded issue. This relief will be particularly relevant during the transition period. Registration is not required in these circumstances if all remaining members of the scheme agree.[48]

Excluded issues

A full analysis of the categories of "excluded issues" defined in sec 66 is beyond the scope of this book. However in summary, registration is not required for schemes in which all units have been issued pursuant to one or more of the following:

- issues involving subscription of at least $500,000: sec 66(2)(a)
- issues made to an underwriter: sec 66(2)(b)
- issues made for no consideration: sec 66(2)(c)
- issues made to an executive officer or close relative of an executive officer of the operator or a related body corporate: sec 66(2)(e)
- issues made to certain professional investors, such as dealer licensees acting as principal, trustees of superannuation funds with at least $10,000,000 in net assets, and persons who control at least $10,000,000 for the purpose of investment in securities: reg 7.12.05(a) and (e).

For an issue to be an excluded issue under sec 66(2)(d) (20 offers in 12 months) and sec 66(2)(m) (distribution reinvestment and substitutions) the scheme must be registered. This is because the less than 20 offers exception in sec 66(2)(d) is expressed to apply "except in the case of interests in an unregistered managed investment scheme". Section 66(2)(m) applies "in the case of an issue of interests . . . in a registered scheme".

'Wholesale' schemes

Schemes that require a minimum subscription of $500,000 or are open only to professional investors are sometimes referred to commercially as wholesale schemes. Usually, a wholesale scheme is structured to avoid the prospectus requirements in sec 1018, and therefore is exempt from registration under sec 601ED(2).

However as a practical matter wholesale schemes that are managed investment schemes[49] may require registration if they propose to issue interests to registered schemes. This is because sec 601FC(4) provides that registered schemes cannot invest in other managed investment schemes unless those schemes are registered. Section 601FC(4) is

48. ASIC Policy Statement 136.28.
49. Wholesale schemes are not managed investment schemes if the members have day-to-day control over the operations of the scheme.

discussed in Chapter 5 below. ASIC has granted a modification of sec 601FC(4) to allow investment by responsible entities in a range of unregistered schemes, including certain foreign schemes, in ASIC Class Order 98/55.

Consequences of a failure to register

The scheme may be wound up

Schemes that are operated in contravention of sec 601ED(5) may be wound up at the direction of the Court on the application of ASIC, the scheme operator, or a "member", under sec 601EE(1). "Member" is defined in sec 9 to mean "a person who holds an interest in the scheme", while "interest" is in turn defined in sec 9 as "a right to benefits produced by the scheme (whether the right is actual, prospective or contingent and whether it is enforceable or not)". The Court may make any orders it considers appropriate for the winding up of the scheme, under sec 601EE(2).

Other consequences

Breach of the registration requirement can be restrained by injunction: sec 1324

Operating a managed investment scheme in breach of the registration requirement is a contravention of sec 601ED(5). Under sec 1324(1) the Court may, on the application of ASIC or "of a person whose interests have been, are or would be affected by the conduct", grant an injunction restraining the person from contravening the Corporations Law or requiring the person to do any act or thing. Where the Court has power to grant an injunction under sec 1324(1), it also has the power to make orders for the payment of damages.[50]

Injunctive relief will often be highly appropriate where a scheme is being operated in breach of the registration requirement. In *Von Leiven* v *Stewart; Kermish* v *Godfrey & Anor,* Handley JA in the NSW Supreme Court expressed the view in relation to the predecessor injunction provisions that "it would be quite wrong in my opinion to view criminal proceedings as the best or primary method of enforcing [the prescribed interest provisions]. In my opinion the effective method of enforcement is by civil proceedings for injunctions which can shut down illegal activity very quickly and *before* investors have parted with their money."[51]

Orders under sec 1325

Regulation 5C.11.07 extends the operation of sec 1325 to contraventions of Chapter 5C, including contravention of the registration requirement in sec 601ED. Section 1325 gives

50. Section 1324(10).
51. (1990) 8 ACLC 1,014, 1024.

the Court extensive power to make orders on the application of any person who has suffered, or is likely to suffer, loss or damage because of conduct that contravened Chapter 5C, including orders setting aside any contract or to pay damages. The application of sec 1325 in the context of managed investment schemes is described in Chapter 8 below.

The operator commits an offence

A person who operates a managed investment scheme that is required to be registered under sec 601ED(1), but is not registered, contravenes sec 601ED(5). Contravention of sec 601ED is an offence under sec 1311, attracting penalties:

- for natural persons, of a fine of 200 penalty units or imprisonment for 5 years, or both, and
- for bodies corporate, of a fine of 1,000 penalty units.[52]

"Operate" is not defined in this context (the expression is also used in sec 601FB(1)), and should be given its ordinary meaning. Section 601ED(6) provides that, for the purposes of sec 601ED(5), a person is not operating a scheme merely because they are acting as an agent or employee of another person, or they are taking steps to wind up the scheme or remedy a defect that led to the scheme being deregistered.

Subscription contracts are voidable

If a managed investment scheme is being operated in contravention of sec 601ED(5), and a person offers interests in the scheme for subscription, or issues an invitation to subscribe for interests, any resulting contract to subscribe for interests is voidable at the option of the offeree under sec 601MB(1). Section 601MB is discussed in Chapter 8 below.

The structural and operational requirements in Chapter 5C do not apply

The effect of much of former Divisions 5 and 5A of Part 7.12 was that operators of schemes that were required to have an approved deed, but did not, were made subject to the same operational and structural requirements that applied to the operators of complying schemes. This was done by deeming the operator to be bound by the prescribed covenants that were the source of the operator's obligations under the previous law.[53]

The operation of Chapter 5C is different. The structural and operational requirements (such as the obligations imposed on responsible entities under sec 601FC) apply only to registered schemes. If a scheme is required to be registered under sec 601EB, but is not registered, the provisions of Chapter 5C that apply in relation to registered schemes will not apply to that scheme.

52. Schedule 3 and sec 1312.
53. Former sec 1069(8).

Chapter 3

Establishing a Registered Scheme

Section 601ED(6) prohibits a person from operating a managed investment scheme that is required to be registered unless the scheme is so registered. Section 601ED(1) is to the effect that a managed investment scheme (as defined in sec 9) must be registered if:

- it has more than 20 members, or
- it is promoted by a professional promoter, or
- it is one of a group of schemes declared by ASIC to be closely related, and the related schemes in aggregate have more than 20 members,

unless all issues of interests in the scheme that have been made were excluded issues (disregarding sec 66(2)(da)) when they were made.

This chapter examines the steps necessary to establish a registered scheme. To establish a registered scheme, its proponents must:

- appoint a public company as responsible entity, and obtain for the responsible entity the necessary licence to operate the scheme
- adopt a constitution for the scheme
- adopt a compliance plan for the scheme
- appoint an auditor for the compliance plan
- where required, appoint a compliance committee, and
- obtain ASIC registration of the scheme.

These requirements are discussed below.

Appointment of the responsible entity

Every registered scheme is required to have a responsible entity.[1] The responsible entity is the person "responsible to investors and to public authorities for running the scheme".[2] The responsible entity is required to operate the scheme and perform the functions conferred on it by the scheme's constitution and the Corporations Law.[3]

The role and duties of the responsible entity are discussed in Chapter 5 below.

Section 601FA requires that a responsible entity:

- be a public company, and
- hold a dealers licence authorising it to operate a managed investment scheme.

1. Section 601EB(1)(d) provides that, to obtain registration, a scheme must have a responsible entity that meets the requirements of sec 601FA.
2. ALRC/CASAC *Report No 65* Summary para 11.
3. Section 601FB(1).

A public company is a company other than a proprietary company.[4] There is no requirement that the company be a company limited by shares,[5] although this is the most common corporate form adopted.

The responsible entity must hold a dealers licence issued by ASIC in accordance with Part 7.3 of the Corporations Law. Licensing of responsible entities is dealt with specifically in ASIC Policy Statement 130. ASIC has developed detailed eligibility criteria for, and is empowered to impose stringent conditions on, licences, and the licensing process represents a significant means by which ASIC can impose quite specific structural and operational requirements on schemes.

ASIC interprets the requirement in sec 601FA that the responsible entity hold a dealers licence authorising it to operate "*a* managed investment scheme" (emphasis added) as being a requirement to hold a licence authorising it to operate *the particular* scheme, or to operate a scheme or schemes of that *particular kind*, classified according to the type of assets held in the scheme.[6]

Dealer licensing

Application for a licence must be made under sec 782 by completing and lodging with ASIC a Form 701 completed in accordance with the guidelines set out in the ASIC Licensing Kit. The policy in accordance with which ASIC applies the licensing laws to responsible entities of managed investment schemes is set out in ASIC Policy Statement 130.

Before granting a licence, ASIC must be satisfied that the educational qualifications and experience of each responsible officer of the applicant are adequate having regard to the duties the officer would perform in connection with the holding of the licence, and that there is no reason to believe that the applicant will not perform efficiently, honestly and fairly the duties of a holder of a licence of the kind applied for.[7] In addition (as a result of an amendment to the bill in the Senate on 23 June 1998), ASIC must be satisfied that the value of the net tangible assets of the applicant is and will be maintained at a minimum of $50,000 or, where the value of all scheme property is greater than $10,000,000, and amount equal to 0.5% of those assets shown in the latest accounts of the scheme lodged with ASIC, up to a maximum of $5,000,000.[8] ASIC can grant an exemption from this requirement, but only in accordance with sec 784(2D). ASIC has indicated that it is unlikely to grant an exemption except in exceptional circumstances.[9]

"Net tangible assets" is defined in sec 784(2C). The manner in which ASIC calculates the necessary amount (including where scheme or company accounts have not been lodged) is set out in ASIC Policy Statement 131.

ASIC can impose conditions on the licence under sec 786. ASIC generally imposes quite extensive licence conditions, including conditions that the responsible entity must:

4. Section 9.
5. Section 112.
6. ASIC Policy Statement 130.21.
7. Section 784(2)(c) and (d).
8. Section 784(2A).
9. ASIC Policy Statement 131.14.

- before 1 July 1999, become a member of an external complaints resolution scheme approved by ASIC and have in place complaints resolution procedures: ASIC Policy Statement 130.64
- have access to sufficient financial resources to meet ongoing scheme related cash requirements, which would arise under reasonably foreseeable circumstances, for a minimum of three months: ASIC Policy Statement 131.16
- have and maintain professional indemnity insurance and insurance against fraud of its officers and agents: ASIC Policy Statement 131.18
- undertake exception reporting to ASIC: ASIC Policy Statement 130.63
- comply with ASIC's policy on custody of scheme assets: ASIC Policy Statement 133.

If a breach of a licence condition occurs, the responsible entity is required to notify ASIC under sec 787, and under sec 826 and 827 ASIC may revoke or suspend the licence after a hearing. In addition, ASIC has power under sec 825A to revoke a responsible entity's licence without a hearing if it is satisfied that the members of the scheme have suffered or are likely to suffer loss or damage because of a contravention of the Corporations Law. The Explanatory Memorandum indicates that, where ASIC takes this action, "it would also take steps for a temporary responsible entity to be appointed to the scheme" under sec 601FN.[10]

Licensing, and in particular the capital requirement in sec 784(2A), is the principal means by which the law seeks to protect against institutional risk.[11]

The scheme constitution

Section 601EB(1)(e) provides that, to obtain registration, a scheme must have a constitution that meets the requirements of sec 601GA and 601GB. The constitution is the document under which the scheme is constituted and in accordance with which the scheme is operated. Section 601GA prescribes in general terms the content of scheme constitutions. Section 601GB requires that the constitution be contained in a document "that is legally enforceable as between the members and the responsible entity".

ASIC Policy Statement 134 provides guidance on how, on receipt of an application for registration, ASIC will "assess a scheme's constitution, and decide whether or not a scheme's constitution meets the content requirements of sec 601GA".[12]

Compliance with the constitution by the responsible entity, except to the extent that it is inconsistent with the Corporations Law, is required under sec 601FC(1)(m). Officers of a responsible entity are required to take all reasonable steps to ensure that the responsible entity complies with the constitution.[13] In addition, sec 601GB requires that the constitution be enforceable as between the members and the responsible entity, giving the members private law remedies (for example, in contract or trust) for breach.

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10. Explanatory Memorandum para 8.3.
11. See ALRC/CASAC *Report No 65* para 10.27–10.34.
12. ASIC Policy Statement 134.1.
13. Section 601FD.

For schemes constituted as trusts, the constitution will be a trust deed. For other schemes, the constitution may be a contract such as a management agreement. Unlike the former Part 5 of Division 7.12, Chapter 5C does not require that the constitution be contained in a deed although the use of a deed may be one way to satisfy the requirement in sec 601GB that the constitution be legally enforceable by all the scheme members, even if they are not signatories to it.

Contents of the constitution

Under the former Division 5 of Part 7.12 approved deeds (which were equivalent to the constitutions of schemes under that law) were required to contain a number of prescribed covenants set out in the former sec 1069 of the Corporations Law and the regulations made under it. Chapter 5C does not include a list of prescribed covenants — instead some of the obligations found in the old prescribed covenants have been moved into the law itself (for example, in sec 601FC(4)) while the remainder have been removed, or relate to matters (such as valuation procedures) that must be dealt with in the compliance plan.

Section 601GA provides that certain matters must be addressed in the constitution, and leaves it up to the responsible entity as to the form and content of the required provisions (although the responsible entity's freedom in determining the appropriate form and content may be limited by ASIC Policy Statement 134). The required matters are discussed below.

The responsible entity is under an obligation to ensure that the constitution meets these content requirements.[14] Failure to do so may expose the responsible entity to liability under the civil penalty provisions (Part 9.4B) and to civil liability. ASIC is not required to register a scheme where it appears to ASIC that the constitution does not comply,[15] and a registered scheme with a non-complying constitution is liable to be deregistered by ASIC under sec 601PB(1)(b).

Calculating the issue price

Section 601GA(1)(a) provides that the constitution of a registered scheme must make "adequate" provision for the consideration that is to be paid to acquire an interest in the scheme. In practical terms, this will mean that the constitution must include provisions for calculating the issue price.

ASIC considers that, for these purposes, "adequate provision has been made when a constitution provides for an independently verifiable price".[16] This is consistent with the ASC's earlier policy on former sec 1069(1)(b)(ii), set out in its Policy Statement 55.24 and Policy Statement 23.30. ASIC's extensive policy on this requirement, and the circumstances in which it will grant relief, are set out in ASIC Policy Statement 134:27–47. Broadly, ASIC requires that the formula for calculating issue price be drafted in such a manner that "the amount of consideration [cannot] be influenced by any party who has an

14. Section 601FC(1)(f).
15. Section 601EB(1)(e).
16. ASIC Policy Statement 134.19.

interest in the scheme . . . This means that the consideration is not to be influenced by" the responsible entity, any related party of the responsible entity, any person acting in concert with the responsible entity in setting the consideration, or any other person with an interest in the amount.[17]

To satisfy ASIC's requirement that the formula be independently verifiable, "the scheme's auditor must be able to verify the amount of consideration by referring to the constitution and without referring to [the responsible entity]. If the consideration is based on the value of scheme property, the constitution has to set out how the property will be valued".[18]

However by Class Order ASIC has granted relief to enable the issue of interests otherwise than at a price fixed in accordance with an independently verifiable formula, in the case of:

- placements of quoted prescribed interests
- schemes involving limited pooling
- proportionate issues to members, and reinvestment
- resale of forfeited, partly paid interests, or
- options over interests.

Frequently the pricing provisions in the constitution will be drafted to allow the responsible entity to nominate a percentage discount to the normal issue price for issues made in these circumstances.

Investment powers

Under sec 601GA(1)(b), the powers of the responsible entity in relation to making investments of, or otherwise dealing with, scheme property must be set out in the constitution. ASIC does not interpret this requirement as one that the constitution set out the investment policy, which will usually be contained in the prospectus.[19]

In practice, responsible entities will often be anxious to ensure that the investment power is as broad as possible. Care should be taken, where this is needed, to exclude any restrictions imposed on the responsible entity's investment powers by relevant State *Trustee Acts* or the general law of trusts.

Complaints resolution

A complaints resolution procedure must be set out in the constitution.[20] ASIC has imposed (under the licensing powers and its powers in relation to compliance plans) a requirement for all registered schemes to have a complaints handling procedure that complies with Australian Standard 4269 and to use an external complaints resolution system that is

17. ASIC Policy Statement 134.29.
18. ASIC Policy Statement 134.29.
19. ASIC Policy Statement 134.48.
20. Section 601GA(1)(c).

satisfactory to ASIC.[21] ASIC requires provisions in the constitution consistent with such an approach.

Winding up

The scheme constitution must include provisions for its winding up. ASIC requires that the constitution "set out members' rights in a winding up process consistently with Part 5C.9 of the Law . . . [and contain] provision . . . for the independent sign off of the accounts of a winding up".[22]

Presumably for the provision to be "adequate", the constitution would also need to specify the rights of investors to share in a distribution of scheme assets, their respective priority, and so on.

Fees and expenses of the responsible entity

Section 601GA(2) is to the effect that the responsible entity is only entitled to be paid fees, and to be indemnified out of scheme property for expenses and liabilities incurred in relation to the performance of its duties:

- if its right to do so is specified in the constitution, and
- only in relation to the proper performance of its duties.

By operation of sec 601GA(2), any other agreement or arrangement that purports to confer such a right "has no effect". This section would appear to prevent the payment of additional fees, say, under a separate agreement with all members.

Section 252B(9) may represent the exception to the general rule that the responsible entity's right to an indemnity for costs must be set out in the constitution. It allows the responsible entity to recover from scheme assets the costs of convening a meeting requisitioned by members.

What is less clear is whether the words "agreement or arrangement" extend beyond contractual-type rights. For example, does sec 601GA(2) prevent the payment of fees to a responsible entity under a court order made pursuant to the *Trustee Act 1958 (Vic)* sec 77? Does the section override a responsible entity's right to indemnity and recoupment under the general law? Say, for example, the responsible entity incurred an expense for which it was entitled to be reimbursed under general law principles[23] but which was not covered by the constitution. If a Court order or statutory right of indemnity is an "agreement or arrangement", sec 601GA(2) would appear to preclude a responsible entity from relying on them. However the better view appears to be that the expression "agreement or arrangement" does not extend so far. In these cases the responsible entity may be entitled to receive payment, but would be in breach of its obligation to ensure the constitution complies with sec 601GA through adequately specifying that right.

21. ASIC Policy Statement 134.51.
22. ASIC Policy Statement 134.52–53.
23. See eg *Octavo Investments Pty Ltd* v Knight (1079) 144 CLR 360 at 367 and *Trustee Act 1958 (Vic)* sec 36(4).

In light of the section, it is appropriate to set out the responsible entity's right of indemnity and to receive fees as fully as possible in the constitution.

The requirement that the responsible entity's right to fees and expenses be set out in the constitution affects its contents. The restriction that fees and expenses can be collected only in the proper performance of the responsible entity's duties affects the operation of the provisions included in the constitution. In determining whether the responsible entity has properly performed its duties, the acts and omissions of its agents are to be taken into account under sec 601FB(2)(b). Payments of fees and the exercise of rights of indemnity set out in the constitution are not prohibited by sec 243H as modified by sec 601LC or by reg 5C.7.01(3), which would otherwise apply to related party benefits, under sec 243H(3) as modified by sec 601LC and reg 5C.7.01(4). However it is not clear that payments provided for in the constitution escape reg 5C.7.01(2). The problematic application of reg 5C.7.01 is discussed in Chapter 5 below.

The requirement that fees and expenses be provided for in the constitution appears to extend only to fees and expenses incurred "in relation to the performance of its duties". Arguably, this can be read as a reference to the performance of its duties as responsible entity. The responsible entity may be able to recover fees not set out in the constitution for other services provided, subject to compliance with the related party transaction provisions in Part 5C.7 and reg 5C.7.01. However as a practical matter, reg 5C.7.01(3) may make it extremely difficult for the responsible entity and its agents to receive any fee or payment, or exercise any right of indemnity, from scheme property that is not expressly provided for in the constitution.

The requirement in sec 601GA(2) does not extend to payment of fees or the extension of rights of indemnity to persons other than the responsible entity. However if payments are to be made to others (such as agents) out of scheme property, those payments should be specified in the constitution to avoid problems with reg 5C.7.01(3).

Borrowing powers

If the responsible entity is to have any powers to borrow or raise money for the purposes of the scheme, sec 601GA(3) provides that those powers must be specified in the constitution and any other agreement or arrangement has no effect to the extent that it purports to confer such a power.

The expression "to borrow or raise money" should be treated with some caution, as it is not clear what "raise" means in this context. Does the responsible entity raise money for the purposes of the scheme through issuing additional interests? Does the restriction extend to incurring financial obligations, say through the use of derivatives?

The effect of sec 601GA(3) on third party rights, and on a responsible entity's right of indemnity, where the responsible entity borrows money without being authorised to do so under the constitution is unclear. Assuming the source of the power is not an "agreement or arrangement", and therefore void, the responsible entity would appear to be entitled to an indemnity (provided there was no postponing conduct) and a creditor to be subrogated to that right on ordinary principles. However the responsible entity would be in breach of its obligation to ensure that the constitution contained all relevant borrowing powers.

Withdrawal

If members are to have a right to withdraw from the scheme, that right must be specified in the constitution under sec 601GA(4). "Withdrawal" is not defined although the intention (here and in Part 5C.6) appears to be that withdrawal means the redemption of the member's interest using part of the scheme property. However it is possible that "withdrawal" extends to include the withdrawal of a member from the scheme by the transfer of its interest, and for that reason it may be appropriate to include express provisions in the constitution allowing the member to transfer its interest, where that is appropriate for the relevant scheme.[24]

Under the former Division 5 of Part 7.12 of the Corporations Law, all prescribed interest schemes were required to offer a buy-back facility, under which the management company was required to repurchase interests from members on request (although this requirement was modified in relation to unlisted property trusts by Division 5A, and certain other trusts by ASC exemption). Chapter 5C does not provide for compulsory buy-back by the responsible entity.[25]

Withdrawal is regulated under Part 5C.6 and the provisions included in the constitution must be consistent with the requirements of that Part. Part 5C.6 distinguishes between withdrawal made while a scheme is "liquid" and those made when a scheme is "illiquid", and is discussed in Chapter 8 below.

The content requirement for the constitution is as follows:

- the right to withdraw (if any) must be stated and must be "fair to all the members"
- if the right may be exercised while the scheme is liquid, "adequate procedures for making and dealing with withdrawal requests" must be included, and must be fair to all the members
- if the right may be exercised while the scheme is illiquid, provision for the right to be exercised in accordance with Part 5C.6, and "any other adequate procedures (consistent with that Part) that are to apply to making and dealing with withdrawal requests" must be included, and must be fair to all the members.

ASIC requires that, if there is provision for withdrawal, "the constitution must include a method for calculating the exit price in a way which is fair to all members and independently verifiable. Fairness will normally require that the price depend on appropriate, and reasonably current, valuations of scheme property". The withdrawal provisions may not unreasonably disadvantage one group of members, or be inconsistent with the Corporations Law.[26]

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24. ALRC/CASAC identify "four ways in which an investor may be able to withdraw his or her investment from a collective investment scheme:
    - redeeming his or her interest from the scheme
    - requiring the scheme operator to buy his or her interests in the scheme (buy back)
    - selling his or her interest on a recognised exchange or by private arrangement
    - terminating the scheme and liquidating its assets": ALRC/CASAC *Report No 65* para 7.2.
25. The decision to remove compulsory buy-back is discussed in ALRC/CASAC *Report No 65*, Chap 7.
26. ASIC Policy Statement 134.25, 134.54–55.

The document must be legally enforceable

Section 601EB(1)(e) requires that the constitution comply with sec 601GB in order to be registered. Section 601GB states that "the constitution of a registered scheme must be contained in a document that is legally enforceable as between the members and the responsible entity". ASIC can deregister the scheme under sec 601PB(1)(b) if this requirement ceases to be met.

Except where the constitution is to be executed by the responsible entity and each member, satisfying this requirement requires careful drafting in the constitution to ensure that it is expressed to bind, and enure for the benefit of, all members whether or not they are parties to it. Use of a deed may assist in this regard. It is perhaps regrettable that the enforceability of the constitution is made a matter of obligation, rather than enshrined in legislation in the manner of, say, sec 140 of the Corporations Law.

One matter of uncertainty is whether sec 601GB requires that the constitution be enforceable as between the members inter se, as well as between the responsible entity and each member.[27] Further, it is not clear whether the effect of sec 601GB is intended to be that all provisions of the constitution are enforceable by each member, even where breach of the provision is capable of being ratified by a majority of scheme members, a problem deliminated, in the context of company constitutions, by the second limb of the rule in *Foss v Harbottle*.[28]

As the responsible entity is required to comply with the constitution by sec 601FC(1)(m), and individual scheme members have standing under sec 601MA, sec 1324 and sec 1325 to enforce that obligation, it may be that the document is "legally enforceable" on its terms under Chapter 5C itself, regardless of its form or terms.[29]

The compliance plan

Under sec 601EB(1)(f) and (g), each scheme must have a compliance plan that meets the requirements of sec 601HA and is signed by the directors in order to obtain registration. The contents of the plan are prescribed by sec 601HA. A copy of the plan must be lodged with the application for registration under sec 601EA(4)(b).

ASIC Policy Statement 132 contains ASIC's policy on the required content of compliance plans. ASIC "actively assess[es] compliance plans when . . . deciding whether or not to register a scheme under sec 601EB(1). We will consider, in the context of the type of

27. Kam Fan Sin "Enforcing the Unit Trust Deed Amongst Unitholders" (1997) 15 *Company and Securities Law Journal* 108. There has long been concern that creating rights as between members will create an association of the type that would offend sec 115.

28. (1843) 2 Hare 461; 67 ER 189. It may be that scheme members are unable to ratify a breach of the constitution on ordinary principles and are in any even unable to ratify a breach of the responsible entity's obligation, in sec 601FC(1)(m), to comply with the constitution — see Chapter 5 below.

29. The scheme members' ability to enforce the terms of the constitution under the Corporations Law is discussed in Chapter 8 below.

scheme, whether the responsible entity has designed measures which are adequate to address the risks of not complying with its obligations".[30]

The compliance plan is described in the Explanatory Memorandum as "a document that will set out the measures that the responsible entity will apply in operating the scheme to ensure compliance with the Law and the scheme's constitution. The compliance plan will set out the various checks and balances to be in place to ensure that the scheme is operated in accordance with the requirements of the scheme's constitution and the requirements of the Law".[31]

Compliance by the responsible entity with the compliance plan is required by sec 601FC(1)(h), giving the compliance plan force of law. That compliance is audited annually by a registered company auditor (sec 601HG) and, unless at least half of the responsible entity's directors are "external directors" within the meaning of sec 601JA(2), must be monitored by a "compliance committee" established under Part 5C.5.

A mandatory compliance plan having force of law was not among the ALRC/CASAC recommendations. The ALRC/CASAC *Report No 65* noted that good compliance systems were central to dealing with compliance risk in managed investment schemes, and urged that the law "underwrite the desirability of operators implementing" measures that are "reasonably likely to detect in advance and prevent a potential breach of the law or the scheme's constitution".[32] It proposed doing so through two mechanisms:

- making adopting an appropriate compliance system a condition of obtaining a licence, and
- making the presence of a compliance system a defence to prosecutions for breach of the Law.[33]

The difference in legal effect between making a compliance plan a defence to prosecutions, and making it a compulsory source of legal obligations, is significant.

Contents of the compliance plan

Section 601HA requires a that a compliance plan "set out adequate measures that the responsible entity is to apply in operating the scheme to ensure compliance with this Law and the scheme's constitution". Those measures must include arrangements for the matters specified in sec 601HA(1)(a) — (f) and, where relevant, sec 601HA(2). Failure by the responsible entity to "ensure the scheme's compliance plan meets the requirements of section 601HA" is a breach of sec 601FC(1)(g).

The compliance plan must be signed by all the directors of the responsible entity before it is lodged with ASIC.[34]

30. ASIC Policy Statement 132.14.
31. Explanatory Memorandum para 10.1.
32. ALRC/CASAC *Report No 65* para 9.5.
33. ALRC/CASAC *Report No 65*, para 9.5–9.7.
34. Section 601HC.

ASIC Policy Statement 132

ASIC's lengthy policy on compliance plans is set out in Policy Statement 132. Registration must be refused to any scheme where it appears to ASIC that the compliance plan does not meet the requirements of sec 601HA, and ASIC has indicated that it "will actively assess compliance plans when we are deciding whether or not to register a scheme under sec 601EB(1)".[35] In addition, ASIC has the power to require modifications to a compliance plan, under sec 601HE(2). Therefore particular attention should be given to the content requirements imposed by ASIC.

Measures adequate to ensure compliance

The requirement in section 601HA that the plan be "adequate" to "ensure" compliance does not include any element of reasonableness. It is difficult to see what could constitute "adequate measures . . . to ensure compliance" other than a system that, examined retrospectively, has that effect. In other words, if a responsible entity has a compliance system in place that is approved by the regulator and meets current industry standards of reasonableness, but a loss nevertheless occurs, it may be open to a court to decide that, *ipso facto*, the system was inadequate on this test. The only alternative is to interpret the word "adequate" in this section as meaning "reasonably likely to detect in advance and prevent a potential breach of the law or the scheme's constitution", the definition of "adequate" that is used in this context in the ALRC/CASAC *Report No 65*.[36] However as a matter of statutory construction it may be difficult to make this argument, especially as the definition does not appear in legislation itself or its Explanatory Memorandum.

Arrangements to be included

Compliance plans must include the arrangements for:

- keeping scheme property separate and clearly identified as such: sec 601HA(1)(a)
- ensuring valuation at appropriate intervals: sec 601HA(1)(c)
- ensuring adequate record keeping: sec 601HA(1)(e)
- ensuring proper audit of compliance with the plan: sec 601HA(1)(d), and
- if a compliance committee is required, its proper functioning: sec 601HA(1)(b).

In addition, if the members of a scheme in existence prior to 1 July 1998 have resolved in accordance with sec 1457(1A) to require the responsible entity to appoint an independent custodian, arrangements to implement that that resolution must be included under sec 601HA(2).

ASIC takes the view that "in addition to the mandatory matters listed in sec 601HA(1) and 601HA(2), there will be many other matters which deserve serious treatment in a

35. ASIC Policy Statement 132.14.
36. See ALRC/CASAC *Report No 65* para 9.5, n 3.

compliance plan".[37] Examples of some of those matters are given in the Annexure to Policy Statement 132.

ASIC gives general guidance on the preparation of compliance plans in ASIC Policy Statement 132.7-14. Policy Statement 132.2 states that, in preparing a compliance plan, the responsible entity should:

- undertake a structured and systematic process which considers the responsible entity's obligations under the Corporations Law and the scheme constitution
- identify the risks of non-compliance, and
- establish measures designed to meet these risks.

The compliance plans submitted to the ASC by proposed trustees of prescribed interest schemes under the former sec 1067(3) may provide some guidance on the types of matters to be included. In addition, trustees of superannuation funds are required to prepare compliance plans to enable the auditor of the fund to give the certificate of compliance required under sec 113 of *Superannuation Industry (Supervision) Act 1993* (Cth), and such plans may provide useful precedents. Australian Standard 3806 — Compliance Programs may also provide some useful guidance.

Detail required

A responsible entity is required by law to adhere to the processes, systems and structures set out in its compliance plan, under sec 601FC(1)(h). The fact that the compliance plan is legally binding suggests that, as a matter of prudence and to permit sufficient flexibility in the conduct of the responsible entity's business, specific, detailed provisions should be avoided. However ASIC has indicated that the provisions of the plan should be sufficiently detailed to enable it and the auditor:

> to assess whether or not a responsible entity has complied with its compliance plan. A compliance plan lodged with us must describe compliance activities with enough detail and certainty for the auditor and [ASIC] to assess, at a later time, whether or not the plan has been complied with. Therefore measures must be described in a way which represents more than mere platitudes or broad ambitions of compliance. Conversely, this does not necessarily mean that a compliance plan should detail each and every step, check, detailed procedure or action.[38]

Under sec 601HD, ASIC has the power to direct the responsible entity of a registered scheme in writing to "give it information about the arrangements contained in the compliance plan". The Explanatory Memorandum states that "such a direction may include, for example, a request for details of computer systems and information storage procedures, manuals which demonstrate internal accounting system procedures, or evidence of custodial arrangements. [ASIC] may also give a direction to provide informa-

37. ASIC Policy Statement 132.9.
38. ASIC Policy Statement 132.17–18.

tion about the current or expected operation of the scheme in relation to which the measures would operate".[39]

Incorporation by reference

Chapter 5C requires a separate compliance plan for each registered scheme. Section 601HB permits a responsible entity to incorporate specified provisions of a compliance plan of another registered scheme of which it is responsible entity into the plan for a new scheme.

ASIC has modified the operation of sec 601HB so that when the incorporated provisions are amended in the principal plan, the effect of the amendment is carried through to the plan into which they have been incorporated.[40]

ASIC has power to request a consolidated copy of a compliance plan, reproducing the provisions incorporated by reference under sec 601HB.[41]

Scheme property arrangements

Specific guidance is provided by ASIC in relation to those parts of the compliance plan that deal with custody of scheme property.[42] ASIC's discussion canvasses the compliance measures that should be adopted where a custodian is appointed, and where the responsible entity or a related party holds scheme property.

Appointment of the compliance plan auditor

Part 5C.4 requires the annual audit, by a registered company auditor, of compliance by the responsible entity with the compliance plan. The auditor is also required to report on whether "the plan continues to meet the requirements of the Part", in particular sec 601HA. The qualifications, powers and functions of the auditor are set out in sec 601HG. Section 601HH governs removal and resignation of auditors, and sec 601HI requires the responsible entity to notify ASIC of a change of auditor.

The requirement to appoint an auditor of the compliance plan is separate from the requirement to appoint an auditor of the scheme's accounts in accordance with Part 2M of the Corporations Law. Part 2M is discussed in Chapter 4 below.

Under sec 601EB(1)(h), it is a prerequisite for registration that the responsible entity have arrangements in place to satisfy the requirements of sec 601HG in relation to audit of the compliance plan. Section 601HA(1)(d) requires that the compliance plan include adequate measures for "ensuring that compliance with the compliance plan is audited as required by sec 601HG". Given that ASIC can refuse registration if the compliance plan

39. Explanatory Memorandum para 10.4.
40. ASIC Policy Statement 132.20–22.
41. Section 601HF.
42. ASIC Policy Statement 133.21–29.

is inadequate in this (or any other) respect, it is not clear what sec 601EB(1)(h) adds to the registration process. It is expected that ASIC will satisfy itself in relation to sec 601EB(1)(h) by examining the provisions of the compliance plan included under sec 601HA(1)(d) and relying on the statement provided by the directors of the responsible entity under sec 601EA(4)(c) that the compliance plan is adequate in this respect.

The person appointed as auditor of the plan must be a registered company auditor.[43] The person may not be:

- an associate of the responsible entity
- an agent holding scheme property on behalf of the responsible entity or an associate of an agent of that kind, or
- the auditor of the responsible entity's financial statements, although the plan auditor may "work for" the same firm of auditors as the auditor of the responsible entity's financial statements.[44]

There appears to be no prohibition on appointing the same person as auditor of the plan and auditor of the scheme.

The role and responsibilities of the compliance plan auditor are discussed in Chapter 6 below. The procedure for resignation or removal of the auditor is discussed in Chapter 4.

Appointment of the scheme auditor

Within one month after the day on which the scheme is registered, or after the day on which the position of auditor becomes vacant, the responsible entity must appoint an auditor of the scheme.[45] The appointment may be of a person or firm, and requires the prior consent of the appointee. Directors of the responsible entity contravene sec 331AB(8) if they fail to take all reasonable steps to secure compliance with the obligation to appoint.

The qualifications of the scheme auditor are set out in sec 331AA. The provisions of sec 331AA are extended by the application of sec 324(3)–(11) and (16) *mutatis mutandis*.[46] A natural person appointed as auditor must be a registered company auditor and cannot be an officer of the responsible entity, a partner, employee or employer of an officer of the responsible entity, or a partner or employee of an employee of an officer of the responsible entity. In addition, if the person or a body corporate in which the person is a substantial shareholder owes more than $5,000 to the scheme's responsible entity, a related body corporate or an entity controlled by the responsible entity, the person is disqualified. As responsible entities are often part of financial services groups, care must be taken with this requirement, although note that sec 324(3) provides that the indebtedness of a natural person to an Australian ADI or insurance company is disregarded.

Similarly a firm cannot be appointed as auditor of a scheme unless at least one member of the firm is a registered company auditor who ordinarily resides in Australia. The firm

43. Section 601HG(1).
44. Section 601HG(2).
45. Section 331AB.
46. Sections 324(3)—(11) and (16) apply by operation of sec 331AA(3) and (4).

must be operating under a registered business name. The firm is disqualified from acting if any member of the firm is an officer of the responsible entity, a partner, employee or employer of an officer of the responsible entity, or a partner or employee of an employee of an officer of the responsible entity. In addition, if any member of the firm, or any body corporate in which a member is a substantial shareholder, owes more than $5,000 to the scheme's responsible entity or an entity controlled by the responsible entity, the firm is disqualified. (Note that, in this case, disqualification does not extend to indebtedness to other related bodies corporate of the responsible entity.) In addition, if an officer of the responsible entity receives any remuneration from the firm for acting as a consultant to it on accounting or auditing matters, the firm is disqualified.

The duties of the scheme auditor, and the requirements for removal or resignation of the auditor, are discussed in Chapter 4 below.

Appointment of the compliance committee

The proponents of the scheme will also be required to constitute a compliance committee, if less than half of the directors on the board of the responsible entity are "external". The obligation to establish the committee arises within 14 days of registration, so it can be considered a requirement connected with the establishment of the scheme.

The compliance committee's function is to assess the adequacy of the compliance plan and to monitor compliance by the responsible entity with it. The requirement to establish a compliance committee and its membership are discussed below. The functions and powers of the committee are discussed in Chapter 6 below, and the duties of its members are discussed in Chapter 7.

The requirement for a compliance committee

The responsible entity must establish a compliance committee if "less than half of the directors of the responsible entity are external directors" as defined in sec 601JA(2).[47] It must do so within 14 days after the obligation arises under sec 601JA(1), unless ASIC has agreed in writing to a longer period.[48] ASIC's consent to a longer period may be made subject to conditions and there is a statutory obligation on the responsible entity to comply with those conditions.[49]

Committee must be established within 14 days

The obligation to establish a compliance committee may arise on registration, where a decision has been made that the board of the responsible entity will not consist of half or more external directors. Alternatively, the obligation to establish a compliance committee

47. Section 601JA(1).
48. Section 601JA(3)
49. Section 601JA(4).

may arise during the operation of the scheme where the composition of the board of the responsible entity changes. In circumstances where the need to establish a compliance committee has been triggered by a change in the composition of the responsible entity's board, it may be of considerable practical importance to apply to ASIC for an extension of time either to reconstitute the responsible entity's board to remove the requirement to comply with sec 601JA(1), or to establish the committee.

ASIC's policy on granting extensions of time is set out in Policy Statement 136.67–81. ASIC notes that it "will not ordinarily extend this 14 day period", but recognises that "it may be impracticable to find suitable compliance committee members within 14 days. For example, on the sudden death of an external member of the board or compliance committee, compliance with the 14 day deadline may be impracticable. It may be especially difficult for smaller specialised business schemes and schemes based in remote locations".[50] In these circumstances ASIC may be prepared to grant an extension of time, subject to conditions such as the appointment of external auditors to carry out substitute compliance monitoring for the period of the relief.

External directors

Section 601JA(2) defines "external director" for these purposes. A director of a responsible entity is an external director if they:

- are not, and have not been in the previous two years, an employee of the responsible entity or a related body corporate
- are not, and have not been in the previous two years, an executive officer of a related body corporate
- are not, and have not been in the previous two years, substantially involved in business dealings, or in a professional capacity, with the responsible entity or a related body corporate
- are not a member of a partnership that is, and has been in the previous two years, substantially involved in business dealings, or in a professional capacity, with the responsible entity or a related body corporate
- do not have a material interest in the responsible entity or a related body corporate, and
- are not a relative or a de facto spouse of a person who has a material interest in the responsible entity or a related body corporate.

"Related body corporate" is defined in sec 50.

Persons who are "executive officers" of related bodies corporate of the responsible entity cannot be treated as external directors. "Executive officer" is defined in sec 9 and means a "person, by whatever name called and whether or not a director of the body . . . who is concerned, or takes part in, the management of the body". Arguably a non-executive director (that is, a person who is a director but not an employee) takes part in the management of a body corporate, therefore the definition may include

50. ASIC Policy Statement 136.76.

non-executive directors (although, in a company law context, it is generally considered only to extend to employees of the body). If "executive officer" does include non-executive directors, sec 601JA(2)(b) has the effect that a person who is:

- a non-executive director of the responsible entity is external, and
- a non-executive director of a related body corporate of the responsible entity is not external.

The expression "substantially involved in business dealings, or in a professional capacity", is not defined, so case law will be required to determine its scope. "Substantial" connotes some element of real importance or value, or of considerable amount (*Shorter Oxford Dictionary*), but even applying this test the matter becomes one of degree. If the responsible entity and its related bodies corporate are customers or clients of the director, when is that relationship "substantial" for these purposes? Presumably the value or importance of the involvement should be measured from the point of view of the director, rather than the responsible entity. If the value of the involvement to the director (in either amount or as a percentage of that director's overall business or profession) is of "real importance", the director cannot be treated as an external director.

Note that where a director is a member of a partnership that has substantial business or professional involvement with the responsible entity, the director cannot be treated as an external director. However it may be that no such restriction applies where the director is an officer, member or employee of a body corporate that is in such a relationship.

Similarly "material interest" is not defined. Regard should be had to the relevant case law and commentary, including on sec 232A, although note that the interest need not be a "personal" one.[51]

"Relative" is defined in sec 9, as is "de facto spouse".

Membership of the compliance committee

If one is required, the compliance committee must have at least three members, and a majority of them must be "external members" as defined in sec 601JB(2).[52] There appears to be no statutory requirement that the member be a natural person.[53]

External members

A member is an external member if they:

- are not, and have not been in the previous two years, a non-external director, an executive officer or an employee of the responsible entity or a related body corporate
- are not, and have not been in the previous two years, substantially involved in business dealings, or in a professional capacity, with the responsible entity or a related body corporate

51. C.f. *Kriewaldt v Independent Direction Ltd* (1995) 14 ACLC 73.

52. Section 601JB(1).

53. Unlike sec 221(3), which expressly requires that a director be a natural person.

- are not a member of a partnership that is, and has been in the previous two years, substantially involved in business dealings, or in a professional capacity, with the responsible entity or a related body corporate
- do not have a material interest in the responsible entity or a related body corporate, and
- are not a relative or a de facto spouse of a person who has a material interest in the responsible entity or a related body corporate.[54]

Sections 601JB(3) and (4) qualify sec 601JB(2). In determining whether a person is an external director of a related body corporate of the responsible entity for the purposes of sec 601JB(2)(a), sec 601JA(2) is applied *mutatis mutandis*.[55] In interpreting sec 601JB(2)(b), the fact that a person has been an external director of the responsible entity, or a member of a compliance committee of anther scheme operated by the responsible entity, is disregarded in deciding whether the person has had substantial business or professional involvement with the responsible entity.[56]

Registration

Section 601EA(1) provides that, to register a managed investment scheme, a person must lodge an application with ASIC. The application must be in the approved form.[57] The contents of the application and the necessary supporting material to be lodged with it are prescribed by sec 601EA(2) and (4) and reg 5C.1.01. ASIC is required to accept an application and register a scheme unless the application is defective in one of the ways mentioned in sec 601EB. Therefore sec 601EA and 601EB (as modified by reg 5C.11.04) together prescribe the criteria for registration.

In summary, those criteria are:

- the scheme must have a responsible entity that is a public company and that holds a dealers licence authorising it to operate the scheme, or schemes of that kind
- the scheme must have a distinctive name
- the scheme must have a constitution that meets the requirements of sec 601GA and sec 601GB
- the scheme must have a compliance plan that meets the requirements of sec 601HA and is signed by the directors of the responsible entity
- the directors of the responsible entity must sign a statement in the approved form that the constitution and the compliance plan comply, respectively, with sec 601GA and 601GB, and sec 601HA, and
- the scheme must appoint, with the person's written consent, an auditor to audit compliance with the compliance plan and must have in place arrangements in relation to that audit that satisfy the requirements of sec 601HG.

54 Section 601JB (2).

55. Section 601JB(3).

56. Section 601JB(4).

57. Regulation 5C.1.01.

Each of those requirements is discussed in detail above. It is important to note that ASIC policy guidelines are of considerable importance in determining the practical requirements for registration.

ASIC's registration power

ASIC is required to register a scheme within 28 days if the application is lodged before 1 July 2000, or 14 days if the application is lodged on or after 1 July 2000, unless "it appears to ASIC" that one of the matters contained in paras (c) to (h) of sec 601EB is present.

Accordingly ASIC is subject to a positive registration requirement and it has no discretion to refuse an application, say, on the grounds that the scheme itself is unsound. In this respect ASIC's registration obligation reflects the deed approval process under the former sec 1067(2) and differs from the predecessor sec 166 of the *Companies Act 1981* and corresponding State and Territory Codes, under which the regulator had the discretion to refuse registration. The registration obligation is in similar terms to sec 1020A(2), which obliges ASIC to register prospectuses, and it is expected that ASIC's view on the extent of its discretions, and the proper role for it in reviewing documents lodged in support of an application for registration, will reflect the approach taken in relation to the prospectus registration process.

The grounds on which ASIC can refuse to register a scheme are set out below. In each case, registration may be refused if "it appears to ASIC" that the relevant matter is made out. Therefore it is ASIC's view of whether, say, a particular document meets the requirements of the law that is conclusive (provided of course that view is properly formed and ASIC's decision making is not defective under ordinary administrative law principles). In determining whether any one of paragraphs (c) to (h) is made out, ASIC will have regard to its published policy on the relevant area.

ASIC is not required to register the scheme if the application does not comply with sec 601EA. To comply, the application must state the name of the scheme and the name and address of the proposed responsible entity and of the person who has consented (in accordance with sec 601EA(3)) to act as auditor of the compliance plan. It must be accompanied by a copy of the scheme constitution, a copy of the compliance plan signed by the directors of the responsible entity in accordance with sec 601HC, and a statement in the approved form signed by the directors of the responsible entity that the constitution and the compliance plan comply with, respectively, sec 601GA and 601GB, and sec 601HA.[58]

The prescribed application fee (currently $1730) must accompany the application.

Regulation 5C.1.01(2) requires that the application for registration "state the name of the managed investment scheme". The stated name must not be the same as the name of another scheme the subject of a registration application, or a registered scheme.[59] ASIC

58. Section 601EA and reg 5C.1.01.

59. Regulation 5C.1.01(3).

must not register a scheme if the name of the scheme does not comply with reg 5C.1.01(3).[60]

The grant of registration

Unless ASIC is satisfied that one of the matters in sec 601EB(1)(c)–(h) is made out, it must register a scheme the subject of a valid application for registration within the time required under sec 601EB(1)(a) or (b) as the case may be.

Unlike registration of companies under Chapter 2A of the Corporations Law, registration of a managed investment scheme under sec 601EB does not create or incorporate the scheme. The register is maintained simply as a record of schemes in existence that have been registered, either to avoid a contravention of sec 601ED(5) or, in the case of some wholesale schemes, voluntarily so that the scheme is a permitted investment for other registered schemes under sec 601FC(4). ASIC's obligation to keep a record of the schemes it registers is contained in sec 601EB(3).

On registration, the scheme will be allocated a distinctive Australian Registered Scheme Number (*ARSN*) under sec 601EB(2).

60. Regulation 5C.11.04.

Chapter 4

Administering and Altering Schemes

This Chapter is divided into two parts. The first part deals with the ongoing administrative obligations imposed by the Corporations Law in relation to registered schemes. These include disclosure and reporting obligations and obligations to maintain prescribed registers. The second part deals with amendments to the constituent documents and personnel of the scheme, and examines the process for amending the constitution and the compliance plan, and changing responsible entity, auditors and compliance committee members.

Disclosure requirements

All registered schemes are subject to periodic reporting obligations under Chapter 2M of the Corporations Law. In addition, certain registered schemes are subject to the continuous disclosure rules contained in sec 1001A–1001D. The disclosure requirements are the same as those imposed on companies the subject of the relevant provisions. Their particular application to managed investment schemes is outlined below.

Periodic reporting

Periodic reporting obligations are imposed in relation to registered schemes by Chapter 2M of the Corporations Law. Section 285(3) provides that, for the purpose of applying Chapter 2M to a registered scheme:

- the scheme's responsible entity is responsible for the performance of obligations in respect of the scheme
- the directors and officers of the responsible entity are taken to be the directors and officers of the scheme, and
- the debts incurred in operating the scheme are to be taken to be the debts of the scheme.

The key obligations imposed under Chapter 2M are set out below. Part 2M.2 deals with financial records, and Part 2M.3 with financial reporting. ASIC has the power to grant relief from the provisions of Part 2M.2 and 2M.3, under Part 2M.6. If a director of the responsible entity fails to take all reasonable steps to comply with or to secure compliance with Part 2M.2 or 2M.3, the director contravenes sec 344 which is a civil penalty provision under sec 1317DA.

Financial records

The responsible entity of a registered scheme is required to keep written financial records that correctly record and explain the transactions and financial position of the scheme and would enable true and fair financial statements to be prepared and audited.[1] The manner in which the records must be kept is prescribed by Part 2M.2. Where the responsible entity is a trustee, the statutory obligation to keep financial records will overlap with its obligation under the law of trusts to keep and render proper accounts.[2]

Annual financial report

All registered schemes, regardless of their size, are required to prepare a financial report and a directors' report for each financial year of the scheme.[3] The financial report consists of the financial statements[4] for the year, the notes to the financial statements[5] and the directors' declaration[6] about the statements and notes.[7]

The financial report must comply with the accounting standards,[8] and together with the notes must give a true and fair view of the financial position and performance of the scheme.[9]

The directors' declaration given in accordance with sec 295(4) must include a solvency declaration. That declaration goes to whether the "registered scheme" will be able to pay the debts incurred in operating the scheme as and when they become due and payable. In cases where the scheme itself is not a legal entity (for example, where the scheme is a trust), the capacity of the "scheme" to meet its debts will no doubt turn on the ability of the person by whom they were incurred (usually the responsible entity or its agent) to meet them. This may involve consideration of whether the responsible entity or agent is able, from its own resources or through a right of indemnity against trust assets, to meet the scheme's debts as required.

The financial report must be audited.[10] Audit is discussed below.

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1. Section 286.
2. *Jacobs' Law of Trusts* [1713].
3. Section 292.
4. Comprising a profit and loss statement, a balance sheet and a statement of cash flows — sec 295(2).
5. Comprising the disclosures required by the Corporations Regulations, the notes required by the accounting standards and any other information necessary to give a true and fair view of the financial position and performance of the scheme — sec 295(3).
6. The form of the directors' declaration is prescribed by sec 295(4). In the case of a registered scheme, the declaration is made by the directors of the responsible entity. The directors must resolve that the financial statements and notes comply with the accounting standards and give a true and fair view of the financial position and performance of the scheme. In addition, the directors must declare whether, in their opinion, there are reasonable grounds to believe that the registered scheme will be able to pay its debts as and when they become due and payable.
7. Section 295(1).
8. Section 296.
9. Section 297.
10. Section 301.

Directors' report

All registered schemes must also prepare a directors' report for each financial year.[11] The report is prepared by the directors of the responsible entity. The report must include the general information required under sec 299 (including a review of operations, and details of significant changes in the scheme's state of affairs or activities and likely future developments) and the specific information required under sec 300 (including details of distributions, details of directors of the responsible entity, information relating to options over unissued interests and details of indemnities given to and insurance premiums paid for insurance of officers of the responsible entity).

The directors' report must also include details of:

- the fees paid to the responsible entity and its associates out of scheme property during the financial year
- the number of interests in the scheme held by the responsible entity and its associates at the end of the financial year
- interests in the scheme issued during the financial year
- withdrawals from the scheme during the financial year
- the value of scheme assets as at the end of the financial year, and the basis for the valuation, and
- the number of interests in the scheme as at the end of the financial year.[12]

If the scheme is a listed scheme, the report must also include a statement of any relevant interest of a director of the responsible entity in interests in the scheme and any rights or options over interests, and details of any contracts under which a director is entitled to a benefit and that confers a right to call for or deliver interests in the scheme.[13]

Half-yearly reporting

If the scheme is a "disclosing entity", half-yearly reporting is required under Division 2 of Part 2M.3. A registered scheme will be a disclosing entity if interests in the scheme are "ED securities",[14] that is, if (among other things) they are quoted on a stock market of a stock exchange[15] or if they have been issued pursuant to a prospectus and there have been 100 or more members since the issue.[16]

So where the scheme is listed or interests in the scheme are widely held, it is likely that the responsible entity will be subject to half-yearly reporting in respect of the scheme. Section 302 requires:

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11. Section 298.
12. Section 300(13).
13. Section 300(12).
14. Section 111AC(2).
15. Section 111AE.
16. Section 111AF.

- preparation of a financial report and directors' report for each half-year
- audit or review of the financial report and provision of an auditor's report, and
- lodgment of the financial report, the directors' report and the auditor's report with ASIC.

The financial report and directors' report must be prepared in accordance with sec 303–306.

Audit of annual and half-yearly reports

The annual financial report prepared in accordance with sec 292 must be audited in accordance with Division 3 of Part 2M.3, and an auditor's report provided.[17] If a half-yearly report is required under sec 302, that report must also be audited in the manner prescribed. The requirements for audit are set out in Division 3 of Part 2M.3. The auditor is required to report to members under sec 308 and 309. The auditor is also required to notify ASIC if he or she has reasonable grounds to suspect that a contravention of the Corporations Law has occurred, and believes that the contravention has not been or will not be adequately dealt with by commenting on it in the auditor's report or bringing it to the attention of the directors of the responsible entity.[18]

Annual reporting to scheme members

The responsible entity is required to send scheme members,[19] within three months of the end of the scheme's financial year:

- copies of the financial report, the directors' report and the auditor's report, or
- a concise financial report prepared in accordance with sec 314(2).[20]

Members may request the form of disclosure they require, or elect not to receive the information.[21]

Lodgment with ASIC

The financial report and directors' report prepared in accordance with Division 1 of Part 2M.3 must be lodged with ASIC within three months of the end of the scheme's financial year.[22] If half-yearly reports are required, they must be lodged with ASIC within 75 days after the end of the half year.[23]

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17. Section 301.
18. Section 311.
19. "Member", in the context of managed investment schemes, is defined very broadly, and it may be difficult for a responsible entity to ascertain finally the extent of the membership of the scheme. This problem is discussed in Chapter 8 below. It is hoped that the courts and the regulator will take the view that distribution to all those named in the register of members is sufficient.
20. Section 314 and 315(3).
21. Section 316.
22. Section 319.
23. Section 320.

Continuous disclosure

Schemes that are "disclosing entities" are also subject to continuous disclosure obligations under sec 1001A–1001D of the Corporations Law.[24] Scheme that are listed, or that have issued interests under a prospectus and have had 100 or more members since the issue, will be disclosing entities for this purpose.[25]

If the scheme is listed, the responsible entity[26] is required to disclose information that is not generally available and that a reasonable person would expect, if it were generally available, to have a material effect on the price or value of the quoted interests in the scheme.[27] Disclosure is made by way of a statement to the ASX in accordance with the ASX Listing Rules. If the responsible entity contravenes this requirement, and the contravention is intentional or reckless, the responsible entity commits an offence.[28]

If the scheme is unlisted, disclosure must be made by the lodgment of a document containing the information with ASIC.[29] Again, the obligation to provide the information is imposed on the responsible entity.[30]

Annual returns

The responsible entity of a registered scheme is required under sec 345 to lodge an annual return relating to the scheme within three months after the end of the scheme's financial year.[31] The contents of the annual return are prescribed by sec 349.

Registers

Responsible entities of registered schemes are required to maintain certain registers under Chapter 2C.[32] The responsible entity must set up and maintain a register of members of the scheme[33] in accordance with sec 169, and a register of option holders[34] under sec 170.

The register of members must set out:

- the member's name and address
- the date on which the entry of the member's name in the register is made

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24. On continuous disclosure generally, see Ford, Austin and Ramsay [10.290]ff.
25. See Part 1.2A of the Corporations Law.
26. Section 1001A(4).
27. Section 1001A(2).
28. Section 1001A(3).
29. Section 1001B(1).
30. Section 1001B(4).
31. A different lodgment date may be agreed between ASIC and the responsible entity under sec 345(3).
32. Section 167A(1)(b) and 167A(2).
33. The wide definition of "member" is discussed in Chapter 8. As with the obligation to provide reports to members, the breadth of that definition may create problems for the responsible entity in discharging this obligation.
34. Technically, those who hold options over interests come within the definition of 'member'. However the law requires that a separate register be kept.

- the date on which every issue of interests takes place
- the number of interests in each issue
- the interests held by the member
- the class of interests, and
- the amount paid, or treated as paid, on the interests.[35]

The register of members is also required to retain certain information about former members for seven years after they ceased to be members.[36]

The register of option holders must be maintained in accordance with sec 170, and the responsible entity must keep with the register a copy of every option document (other than for quoted options).

The registers must be open to the public for inspection.[37] The permitted uses of information contained in the register are limited by sec 177.

Applications for rectification of the register can be made to the Court under sec 175. However note that, unlike membership of a company, membership of a registered scheme does not depend on the person appearing in the register of members. A "member" of a managed investment scheme is a person who holds an interest in the scheme.[38]

Names and ARSNs

All registered schemes must have a distinct name.[39] Change of name is governed by reg 5C.1.02. The responsible entity may elect to change the name of the scheme by lodging a notice in the approved form with ASIC.

On registration, ASIC allocates the scheme with an ARSN, or Australian Registered Scheme Number, under sec 601EB(2). After registration, the scheme's ARSN must appear on all documents relating to the scheme that are lodged with ASIC.[40] Note that, unlike a company's ACN that must appear on all public documents, use of the ARSN is limited to documents lodged with ASIC.

Changing the responsible entity

All registered schemes must have a responsible entity that meets the requirements of sec 601FA, otherwise they may be deregistered by ASIC.[41] This part discusses the procedure for changing a scheme's responsible entity.

35. Section 169(1) and (6A).
36. Section 169(7).
37. Section 173. See also sec 1300, 1301 and 1306.
38. Section 9. C.f. sec 246A.
39. Regulation 5C.1.01 and 5C.11.04.
40. Section 601EC.
41. Section 601PB(1)(a).

A change in the responsible entity may occur:

- because the responsible entity wishes to resign
- because the scheme members have voted to remove and replace the responsible entity
- because the responsible entity has ceased to meet the requirements of sec 601FA (say, through licence cancellation), and ASIC or a member has made application to the Court for the responsible entity to be replaced, or
- because ASIC or a member has made application to the Court to have a temporary responsible entity appointed to protect scheme property or the interests of members of the scheme.

Replacing the responsible entity may involve either one or two steps. Where the responsible entity has resigned or been removed and another person meeting the qualifications set out in sec 601FA is available and has consented to be appointed as the responsible entity, Part 5C.2 of the Corporations Law lays down a procedure for that person to be so appointed with the consent of the members. The new appointment becomes effective upon alteration of ASIC's register.

Where the scheme does not have a responsible entity meeting the requirements of sec 601FA, or the responsible entity wishes to resign but the members have not agreed to the appointment of the proposed replacement responsible entity, the Court may, on the application of a person with standing under the relevant section, appoint a "temporary responsible entity" in accordance with sec 601FP. The temporary responsible entity is then responsible for taking steps for the appointment of a new responsible entity.[42]

The grounds and procedure for replacing the responsible entity are set out in Division 2 of Part 5C.2. The consequences of a change of responsible entity are set out in Division 3 of Part 5C.2.

Generally speaking changes to the responsible entity require the consent by extraordinary resolution of the scheme members. "Extraordinary resolution" is defined in sec 9 and is "a resolution passed by at least 50% of the total votes that may be cast by members entitled to vote on the resolution (including members who are *not* present in person or by proxy)" (emphasis added). For schemes in which voting participation rates are low, the threshold can be a difficult one to meet.

It should also be noted that a person can be appointed as a replacement responsible entity or temporary responsible entity only if the person is a company meeting the requirements of sec 601FA.[43] Given the stringent licensing conditions that apply under Part 7.3 (in particular, sec 784(2A)), there may be a very limited pool of people available to act as responsible entities, particularly where the change in responsible entity is required following the failure of the incumbent. ALRC/CASAC, in *Report No 65*, had proposed that a temporary responsible entity appointed by the Court need not meet these requirements, leaving the way open for the appointment of a natural person such as an administrator as temporary

42. Section 601FQ. The statutory functions of the temporary responsible entity are discussed in Chapter 5 below.
43. Section 601FK.

responsible entity where this is appropriate.[44] This option may not be available under sec 601FP, although it is noted that the Court has power to make "any further orders it considers necessary" under sec 601FP(2).

Retirement of the responsible entity

The procedure for retiring is set out in sec 601FL. In practice, the procedure is as follows:

- If the retiring responsible entity has chosen a successor that meets the requirements of sec 601FA (i.e., is a public company and holds a dealers licence authorising it to operate the scheme) and that has consented to act as responsible entity for the scheme, the responsible entity must call a meeting of members to "explain its reasons for wanting to retire" and to allow members to "vote on an extraordinary resolution to choose a company to be the new responsible entity".[45]
  - If the members approve the proposed successor by extraordinary resolution, the retiring responsible entity (or, if it fails to do so, the successor) must lodge a notice in the approved form with ASIC as soon as practicable and in any event within two business days.[46] ASIC then alters its record of scheme registration to show the successor as the new responsible entity and the change becomes effective at that time.[47]
  - If the members do not approve the proposed successor the retiring responsible entity may apply to the Court for appointment of a temporary responsible entity.[48] Alternatively, the responsible entity may apply to the Court to wind up the scheme on just and equitable grounds.[49]
- If the retiring responsible entity has not chosen a successor, it seems likely that the responsible entity would make application to the Court to wind up the scheme on just and equitable grounds.[50] It would appear impossible to follow the procedure in sec 601FL where no successor has been chosen. Note that a purported resignation by a responsible entity cannot be effective until a successor is included in ASIC's register and is ineffective unless it is in accordance with Division 1 of Part 5C.2.[51]

Removing the responsible entity

Members can resolve by extraordinary resolution to remove the responsible entity.[52] The procedure is as follows:

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44. See ALRC/CASAC *Report No 65* para 14.20
45. Section 601FL(1).
46. Section 601FL(2) and reg 5C.2.03.
47. Section 601FJ.
48. Section 601FL(3).
49. Section 601ND(1).
50. Section 601ND(1).
51. Section 601FJ.
52. Section 601FM.

- If the members initiating the action nominate a replacement responsible entity that meets the requirements of sec 601FA (i.e., is a public company and holds a dealers licence authorising it to operate the scheme) and that has consented to act as responsible entity for the scheme, those members may call a meeting in accordance with Division 1 of Part 2G.4 to consider and vote on an extraordinary resolution to remove the responsible entity and a separate extraordinary resolution approving the new responsible entity.
  - If both resolutions are passed, the retiring responsible entity (or, if it fails to do so, the replacement) must lodge a notice in the approved form with ASIC as soon as practicable and in any event within two business days.[53] ASIC then alters its record of scheme registration to show the replacement as the new responsible entity and the change becomes effective at that time.[54]
  - If the first but not the second resolution is passed, the scheme must be wound up in accordance with sec 601NE.
- If the members initiating the action have not nominated a replacement responsible entity, usually the appropriate course will be to apply to wind up the scheme under sec 601NB.

The responsible entity ceases to meet the requirements of sec 601FA

If the scheme ceases to have a responsible entity that meets the requirements of sec 601FA, a member or ASIC may apply to the Court for the appointment of a temporary responsible entity.[55] This will occur if the responsible entity is deregistered or changes type and ceases to be a public company, or if it loses its dealers licence. Note that it cannot occur as a result of a responsible entity resigning because no resignation is effective unless it is made in accordance with the Division.[56]

As an alternative to applying for the appointment of a temporary responsible entity in these circumstances, ASIC may deregister the scheme[57] and apply for its winding up.[58] A member may elect to approach the Court for winding up on just and equitable grounds.[59]

Appointment of a temporary responsible entity

Appointment of a temporary responsible entity may be made by the Court under sec 601FP(1), following application under sec 601FL or sec 601FN, if the Court is satisfied that the appointment is "in the interests of members". Where the appointment is made on application of a member under sec 601FN, the member must lodge a notice with ASIC in the approved form.[60] Where the appointment resulted from an application made by the

53. Section 601FM(2) and reg 5C.2.03.
54. Section 601FJ.
55. Section 601FN.
56. Section 601FJ.
57. Section 601PB(1)(a).
58. Section 601ND.
59. Section 601ND
60. Regulation 5C.2.04.

responsible entity, the responsible entity must lodge a notice in the approved form as soon as practicable after the order.[61] As soon as practicable after the appointment of a temporary responsible entity, ASIC must alter its register to reflect the change.[62]

Alternatively, ASIC or a member may apply to the Court for the appointment of a temporary responsible entity if they reasonably believe that the appointment is necessary to protect scheme property or the interests of members of the scheme, under reg 5C.2.02. The criteria the Court is to apply in deciding whether to grant the application are not specified. The fact that reg 5C.2.02 is drafted in a manner similar to sec 601FN suggests that, possibly, the intention was that applications made under reg 5C.2.02 be dealt with under sec 601FP, although this is not made clear by the drafting.

A temporary responsible entity has specific functions and duties that are prescribed by the legislation. These functions and duties are described in Chapter 5 below.

Consequences of the appointment of a new responsible entity

Division 3 of Part 5C.2 sets out the consequences of a change of responsible entity. Under sec 601FR, the former responsible entity is required to hand over all books and give other "reasonable assistance" to facilitate the changeover.

Sec 601FS deals with the transfer of "rights, obligations and liabilities" from the former responsible entity to the new responsible entity. Any rights, obligations and liabilities of the former responsible entity "in relation to the scheme" become rights, obligations and liabilities of the new responsible entity, other than:

- the former responsible entity's right to fees for functions performed before the changeover
- the former responsible entity's right to recover expenses incurred before the changeover
- former responsible entity's rights, obligations and liabilities as a member of the scheme, and
- any liability for which the responsible entity could not be indemnified out of scheme property if it had remained as responsible entity (for example, because the right was not specified in the constitution or the liability had been incurred in breach of trust).

Note that the former responsible entity's right to recover fees and expenses appears to be limited to actions taken before the changeover. If it is intended that the responsible entity be able to recover costs incurred in relation to the changeover after the date on which ASIC's record of registration is altered, or is to be paid a retirement fee, care must be taken to ensure that sec 601FS does not interfere with the right of the former responsible entity to recover those amounts.

Section 601FT is intended to facilitate the changeover of responsible entities by providing that any document to which the former responsible entity was a party should be read

61. Section 601FP(3) and reg 5C.2.05.
62. Section 601FP(4).

after changeover as if the new responsible entity (and not the former) were a party to it. The section itself is not confined to documents connected to the scheme although to read it more broadly than that would appear to produce an absurd result. If the section is effective, it should not be necessary to novate or assign any document to which the responsible entity, in its capacity as such, was a party where the identity of the responsible entity changes.

Changing the composition of the compliance committee

It was noted in Chapter 3 above that, if the compliance committee ceases to have a majority of external members, the responsible entity has 14 days to reconstitute the committee to meet that requirement. An extension of time may be granted by ASIC in certain circumstances.[63]

Chapter 5C is silent as to the procedure for appointment and removal of compliance committee members, although details of these arrangements probably should be included in the scheme's compliance plan (and therefore subject to review by ASIC) under sec 601HA(b)(i).

Disclosure

Chapter 5C does not specifically require the responsible entity to disclose the identity of the members of the compliance committee, or their qualifications. That information does not appear on ASIC's record of registration of the scheme. However it may be that the identity of compliance committee members, and changes to the composition of the compliance committee, are matters that should properly be disclosed in the prospectus relating the scheme (under Division 2 of Part 7.12) or under the continuous disclosure requirements of Part 7.11. This will depend on the individual circumstances of the scheme.

Changing auditors

The Corporations Law places restrictions on changes of auditors, that are intended to protect the auditor's independence and enhance their accountability. Those restrictions are described in this section.

Changing the compliance plan auditor

Under sec 601HH(1)(a), the auditor of the scheme's compliance plan must be removed by the responsible entity if it ceases to meet the eligibility criteria set out in sec 601HG(2). In addition, the auditor may:

63. Section 601JB(5) and (6), ASIC Policy Statement 136.67–81.

- be removed by the responsible entity with the consent of ASIC, under sec 601HH(1), or
- resign, with the consent of ASIC, in accordance with sec 601HH(2)–(4).

If the identity of the auditor changes, the responsible entity must notify ASIC of the change as soon as practicable, and ASIC must amend its record of the scheme's registration accordingly.[64]

The procedure for resignation set out in sec 601HH(2)–(4) requires the auditor to apply to ASIC for consent to resign. ASIC may query the auditor as to its reasons for resigning, and any reply given by the auditor is inadmissible in any action against the auditor and cannot be the grounds for prosecution of the auditor. However care should be taken in answering any such query, as it does not appear that the auditor has qualified privilege with respect to any information about the responsible entity or the scheme so provided to ASIC.[65]

The policy in accordance with which ASIC will consent to the resignation of auditors is set out in ASIC Policy Statement 136.40–41.

The date on which the auditor's resignation becomes effective is prescribed by sec 601HH(5).

Changing the scheme auditor

The removal and resignation of the scheme auditor is regulated under Division 1A of Part 2M.4 of the Corporations Law. Section 331AC provides that the auditor may be removed by the responsible entity with the consent of ASIC. Resignation by the auditor also requires ASIC's consent.

Changing the constitution

A scheme constitution may be modified, or repealed and replaced, by special resolution of the members of the scheme, or by the responsible entity if the responsible entity reasonably considers the change will not adversely affect members' rights.[66]

The constitution of a registered scheme should not be amended or repealed if the effect of the change is to leave the scheme without a constitution that meets the requirements of sec 601GA and 601GB, or the responsible entity will be in breach of its obligations under sec 601FC(1)(f) and the scheme will be liable to be deregistered under sec 601PB(1)(b).

Changes not requiring members' consent

The 1995 Bill had required member approval for all amendments to the constitution, whether or not they adversely affected members' rights. The power of the responsible

64. Section 601HI.
65. Section 601HG(8).
66. Section 601GC(1).

entity unilaterally to amend the constitution was introduced into the Managed Investments Bill. It reflects in part the former sec 1069A(7), which permitted modification of an approved deed without the consent of members of a prescribed interest scheme where "the trustee or representative reasonably believes that the modification will not adversely affect the rights of the holders of the relevant prescribed interests".

The question of what constitutes a member's "right" for these purposes remains, as it was under the predecessor legislation, unclear. Arguably "right" is narrower than "interest", which carries with it some notion of commercial interest. The distinction may not be significant, given that in exercising its power under sec 601GC(1)(b) to change the constitution without the consent of members, the responsible entity is required to act in the best interests of members.[67]

When will a change impact on members' rights, for these purposes? Viewed broadly, a member could be said to have a right to have the scheme operated in accordance with the constitution as in effect at the time the member joined the scheme, precluding any amendments without member consent. However a member who elects to join a scheme under which the constitution may be amended by the responsible entity in certain circumstances can be seen to have acquired its interest on that basis, and is therefore subject to such amendments. Accordingly a narrower construction is required. At the opposite extreme, it is arguable that members' 'rights' are limited to their statutory rights that are incapable of being modified or overridden by the constitution itself, and a right to require adherence to the terms of the constitution as in force from time to time. This approach seems too narrow. As a practical matter, it may be appropriate to view 'rights' in this context as encompassing:

- distribution rights
- withdrawal rights
- voting rights
- rights to receive information, and
- rights in respect of scheme property,

and to obtain member consent where the proposed change "adversely affects" those rights.

Paragraph (b) refers to "members' rights" — the use of the plural means it is not clear whether the expression is intended to cover changes that impact only on the rights of one member or class of members. It may be that, in this case, the reference to the plural includes the singular.[68] In any event the differing impact of changes on different members must be taken into account by the responsible entity in exercising its amendment power, under sec 601FC(1)(d).

The responsible entity's assessment of the effect of a proposed change on members' rights must be "reasonable".

67. Section 601FC(1)(c).
68. Section 109R.

Changes requiring member consent

The procedure for amending the constitution in circumstances requiring member approval is discussed in Chapter 8 below. Unless the responsible entity reasonably believes that a proposed change to a constitution will not adversely affect members' rights, a special resolution of the members of the scheme is required.[69] Members' meetings are governed by Part 2G.4 of the Corporations Law.

Part 2F.2 of the Corporations Law, which operates to protect the class rights of members of companies, does not apply to registered schemes. There appears to be no statutory requirement that amendments affecting a class of members of a registered scheme be separately approved by the members of that class (although a resolution passed by a majority adversely impacting on class rights may be open to challenge on other, general law grounds, such as the equitable doctrine of fraud on a power).

It is possible to entrench class protections in the constitution itself. ASIC, by Class Order, has modified the operation of the law so that a modification of a constitution or adoption of a new constitution that may adversely affect the rights of a class of members can only be made by a special resolution if any requirements of the constitution to protect class rights are met.[70]

Section 601GC(1)(a) gives members a veto power over changes to the constitution adversely affecting their rights that are proposed by the responsible entity. What is less clear is whether the members have any power to propose amendments to the constitution. Members holding at least 5% of the votes to be cast, or totalling at least 100, can requisition a meeting to consider and vote on a proposed special resolution.[71] In the context of companies, members' power to requisition a meeting does not extend to impermissible objects, such as seeking a decision by shareholders on a matter that, under the internal governance rules of the company,[72] is solely within the authority of the directors.[73] If the power to propose constitutional amendments is expressly reserved to the responsible entity under the constitution, it may be that, on application of these principles, members cannot initiate constitutional amendment. If the constitution is silent as to whether members have the right to propose constitutional change, the situation may be unclear.

ALRC/CASAC, in its *Report No 65*, gave careful consideration to the question of whether members should have a right to propose constitutional amendments. They recognised that a unlimited right of members to propose constitutional amendments may result in the responsible entity being required to take some action in the management of the scheme that it did not wish to take. It therefore required that the responsible entity consent to any

69. Section 601GC(1)(a).
70. ASIC Policy Statement 136.9 and Class Order 98/60.
71. Section 252G.
72. The replaceable rules, the constitution, or a combination of the replaceable rules and a constitution.
73. *Turner* v *Berner* (1978) CLC 40-421; *NRMA* v *Parker* (1986) 4 ACLC 609. This issue is discussed further in Chapter 8 below.

proposed amendment.[74] If, under the law as enacted, members do have a right to initiate constitutional amendments, the position of the responsible entity in these circumstances appears to be unprotected.[75]

Notifying changes to the constitution

Section 601GC requires that the responsible entity lodge a copy of "the modification or the new constitution" with ASIC, and provides that the modification, or repeal and replacement, cannot take effect until the copy has been lodged.[76] ASIC can direct that a consolidated copy of the constitution be lodged under sec 601GC(3).

Scheme members are entitled to request in writing a copy of the scheme's constitution at any time, on payment of a fee.[77]

Amending the compliance plan

The compliance plan:

- may be amended, or repealed and replaced, by the responsible entity under sec 601HE(1), and
- must be amended in the manner directed by ASIC in a written notice given to the responsible entity under sec 601HE(2).

In exercising its power to amend or replace the compliance plan the responsible entity must have regard to its obligations, including under sec 601FC, to act for a proper purpose and in the best interests of members. The compliance plan of a registered scheme should not be amended or repealed if the effect of the change is to leave the scheme without a plan that meets the requirements of sec 601HA, or the responsible entity will be in breach of its obligations under sec 601FC(1)(g) and the scheme will be liable to be deregistered under sec 601PB(1)(c).

Section 601HE(3) requires lodgment with ASIC of a copy of any modifications or of a replacement plan within 14 days of the change. The directors must sign that copy. There is no separate requirement to notify scheme members of the change, although where appropriate regard should be had to the responsible entity's continuous disclosure obligations under Part 7.11.

ASIC can request lodgment of a consolidation of the compliance plan at any time, under sec 601HF.

74. ALRC/CASAC *Report No 65*, para 11.22.

75. The members' power to propose constitutional amendments is explored further in Chapter 8 below.

76. Section 601GC(3).

77. Section 601GC(4).

Chapter 5

Role and Duties of the Responsible Entity

Chapter 5C prescribes the functions of, and imposes certain duties on, the responsible entity and others involved in the conduct of a registered scheme. The responsible entity is required to undertake certain functions (in particular, to operate the scheme) and must comply with certain statutory duties (including duties of honesty, loyalty and care) in the performance of those functions. The responsible entity is permitted to appoint agents to assist in carrying out its functions. In exercising its functions, the responsible entity is also constrained by the related party transaction provisions in Part 5C.7 and reg 5C.7.01.

This chapter examines the role, duties and disabilities of the responsible entity. The respective roles of the compliance committee and the compliance plan auditor are discussed in Chapter 6 below. The position of individual officers and employees of the responsible entity is discussed in Chapter 7 below.

Functions and powers of the responsible entity

The responsible entity of a scheme is the company named as such in ASIC's register.[1] It was noted in Chapter 3 above that the responsible entity is the person "responsible to investors and to public authorities for running the scheme".[2] The responsible entity is required to operate the scheme and perform the functions conferred on it by the scheme's constitution and the Corporations Law.[3] Its powers and responsibilities are set out in Division 1 of Part 5C.2 and are discussed below. The procedure for changing the responsible entity, and the consequences of such a change, are set out in Divisions 2 and 3 of Part 5C.2 and discussed in Chapter 4 above.

Requirement to operate the scheme

Section 601FB(1) provides that "the responsible entity of a registered scheme is to operate the scheme and perform the functions conferred on it by the scheme's constitution and this Law". The statutory function of a temporary responsible entity is more limited, and is discussed briefly below.

Section 601FB(1) appears both to require the responsible entity to operate the scheme, and to confer power upon it to do so.[4] The obligation on the responsible entity to perform

1. Section 9.
2. ALRC/CASAC *Report No 65* Summary para 11.
3. Section 601FB(1).
4. A scheme in which members control the operation of the scheme is not a "managed investment scheme" — see Chapter 2 above.

the functions conferred on it by the scheme's constitution and the Corporations Law would reflects its obligations, under sec 601GB and sec 601FC(1)(m), to comply with the constitution, and its overarching obligation to comply with the Corporations Law.

Section 601FB(1) may restrict the extent to which the members of the scheme may interfere with its operation. If sec 601FB(1) confers power on the responsible entity to operate the scheme, in the same manner that the replaceable rule in sec 226A confers power on the directors of a company to manage the business of the company, the scheme members would appear to be precluded from interfering with that. Actions by the members of a company that are inconsistent with the power of the directors to manage the business are ineffective,[5] and the same analysis applied in this context would suggest that members cannot interfere with the operation of the scheme by the responsible entity.

It was the intention of ALRC/CASAC that scheme members not have the power to give directions to the responsible entity in relation to the operation of the scheme.[6] The position can be contrasted with the former sec 1069(1)(m), which gave members of a prescribed interest scheme the power to give directions to the manager and the trustee in relation to the operation of the scheme.

Administrative functions

The responsible entity is the person required to perform the various statutory obligations imposed in relation to the scheme under the Corporations Law. These obligations include the obligation to prepare financial reports and directors' reports, lodge annual returns, maintain the registers, appoint the auditors and so on. They are discussed in Chapter 4 above.

Requirement to hold scheme property on trust

Section 601FC(2) provides that "the responsible entity holds scheme property on trust for scheme members". "Scheme property" is defined in sec 9 and means:

- contributions of money or money's worth to the scheme
- money that forms part of the scheme property under the provisions of the Corporations Law or the ASIC Act
- money borrowed or raised by the responsible entity for the purposes of the scheme
- property acquired, directly or indirectly, with, or with the proceeds of, these contributions or money, and
- income and property derived, directly or indirectly, from these contributions, money or property.

ALRC/CASAC *Report No 65* acknowledged that "collective investment schemes may take various legal forms", including trusts, partnerships, limited partnerships and

5. See e.g. *Automatic Self-Cleansing Filter Syndicate Ltd* v *Cunninghame* [1906] 2 Ch 34; *NRMA* v *Parker* (1986) 4 ACLC 609.
6. ALRC/CASAC *Report No 65* para 11.18–11.19.

contractual arrangements.[7] In larger scale schemes the most common form is the unit trust. In schemes structured as trusts, the legal relationship between the responsible entity and the members is one of trustee and beneficiary. Where scheme property is held by a custodian, the responsible entity remains a trustee for members, with the trust property being the responsible entity's equitable interest in the property held by the custodian.

The impact of sec 601FC(2) on the legal relationship between responsible entities and members in schemes not structured as trusts is unclear, particularly in schemes (such as title based time shares and many agricultural schemes) where the scheme property is retained by the members. Section 601FC(2) did not appear in the 1995 Bill and it appears to have been included when the requirement for an independent custodian was dropped from the legislation. Three interpretations of sec 601FC(2) are possible — they are:

- that, where the responsible entity holds scheme property, it does so as trustee for the members
- that the responsible entity is required to hold all scheme property, and does so as trustee
- that the responsible entity is deemed to hold all scheme property for some or all purposes, and does so as trustee.

The first construction seems preferable, and is consistent with the approach recommended by ALRC/CASAC in *Report No 65*, which provided that:

> A scheme operator that holds scheme property must do so on trust for investors. That is, the investors should retain the beneficial ownership of the assets. Where an operator engages a custodian to hold the legal title to scheme assets, the operator should hold on trust for the investors the equitable interest arising under that arrangement. The Review considers that, because of the nature of the activity undertaken, this trust relationship should exist in all collective investment schemes, even those based on contract. This may result in investors in some schemes having a wider range of remedies available than they would otherwise have. The Review *recommends* that the Corporations Law should be amended to provide that, if the operator of a collective investment scheme holds property of the scheme, it will do so on trust for the scheme investors. Schemes in which investors hold the scheme property will not be affected.[8]

The draft legislation prepared by ALRC/CASAC provided that "if the operator of a collective investment scheme holds property of the scheme, it holds it for the use and benefit of the investors in the scheme".[9] Section 601FC(2) is not limited in this way, and it is difficult to determine whether the intention, in including sec 601FC(2), was that it reflect the policy recommendation made by ALRC/CASAC. However adopting either of the other alternative constructions would appear to have significant (and apparently unintended) consequences, including tax consequences, particularly for contract based schemes.

While the better view seems to be that sec 601FC(2) should not been seen as imposing a duty on responsible entities to hold scheme property, the fact that sec 601FC(2) is referred to as a "duty" in sec 601FC(3) may frustrate such an interpretation. Section 601FC(3) refers to "a duty of the responsible entity under subsection . . . (2)", suggesting

7. Ibid para 10.4.
8. Ibid para 9.14.
9. Ibid Vol. 2, draft provision 260AA(1).

that the drafter's intention was that sec 601FC(2) be read as imposing a duty on responsible entities to hold scheme property (as defined) on trust for scheme members.

It will ultimately remain for the courts to determine the scope and effect of sec 601FC(2). At the least, however, it means that where the responsible entity does hold any property that is scheme property as defined in sec 9, it will be a trustee for members. This has significant implications in relation to the duties of responsible entities, discussed below.

Delegation by the responsible entity

Subsection 601FB(2) provides that "the responsible entity has power to appoint an agent, or otherwise engage a person, to do anything that it is authorised to do in connection with the scheme". Where, as in most (if not all) cases, the responsible entity is a trustee for members, this power would appear to be in addition to the responsible entity's power under the general law and the State and Territory *Trustee Acts* to do so.[10]

The Explanatory Memorandum gives as an example of the operation of sec 601FB(2) that "the responsible entity may engage a custodian to hold the scheme property". Responsible entities may also wish to engage investment managers, property managers, back-office service providers, registry services or other agents under this provision. It is not clear whether the words "or otherwise engage a person" are wide enough to confer on a responsible entity acting as trustee the capacity to appoint a delegate to exercise its powers, authorities and discretions, overturning its general law obligation to administer the trust personally.[11]

Use of a custodian

In many cases the responsible entity will be required, as a condition of its dealers licence, to appoint a custodian to hold scheme property on its behalf. In other circumstances a responsible entity may choose to do so in order to satisfy the statutory requirement to hold that property separately from its own,[12] or for commercial reasons. ASIC's policy on the use of a custodian is set out in Policy Statement 133.

A responsible entity that does not itself meet the standards for custody prescribed by ASIC under Policy Statement 133 will be required, as a condition of its licence, to appoint another person to be the custodian of the scheme property.[13] Those standards relate to organisational structure, staffing capabilities, administrative resources, arrangements on how various assets are held, and financial resources.[14]

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10. See *Jacobs' Law of Trusts* [1723]–[1731].
11. *McMillan* v *McMillan* (1891) 17 VLR 33 at 38–9. See *Jacobs' Law of Trusts* [1731].
12. Section 601FC(1)(i), discussed below.
13. See ASIC Policy Statement 133.2.
14. The standards for financial resources are set out in ASIC Policy Statement 131. The custodian (whether the responsible entity itself or an external agent) generally must have net tangible assets of $5,000,000: ASIC Policy Statement 131.20–23.

Where an external custodian is used, ASIC imposes conditions on the terms of the responsible entity's licence and requires certain matters to be included in the compliance plan. As a condition of the licence, the responsible entity will be required to enter into an agreement with the custodian covering the matters set out in ASIC Policy Statement 133.20. This includes agreement as to the form of proper instructions required, and arrangements covering "how the scheme will be compensated if there is a loss to the scheme as a result of the agent failing in its obligations under the agreement".[15]

In addition, where a custodian is used, the scheme's compliance plan should set out the measures that the responsible entity proposes to take to minimize the risk of loss to the scheme. ASIC has indicated that this may include details of measures for ensuring that:

- the agent continues to meet the standards for holding scheme property
- the activities of the agent are actively monitored
- contractual arrangements entered into with the agent remain current and respond to necessary changes, and
- the agent maintains appropriate arrangements with information providers, registries, sub-custodians and clearing systems.[16]

Responsible entity's liability for agents

Section 601FB(2) goes on to provide that:

> For the purposes of determining whether:
> (a) there is a liability to members; or
> (b) the responsible entity has properly performed its duties for the purposes of sec 601GA(2);
> the responsible entity is taken to have done (or failed to do) anything that the agent or person has done (or failed to do) because of the appointment or engagement, even if they were acting fraudulently or outside the scope of their authority or engagement.

The Explanatory Memorandum states that:

> the effect of this provision is to provide that the responsible entity is liable to members for any act or omission in relation to the affairs of the scheme. This places the onus upon the responsible entity to make good to scheme members any losses suffered by a scheme as a result of the conduct of persons engaged by the responsible entity in relation to the scheme. The responsible entity may in turn seek to recover its costs from the other persons.[17]

As such, sec 601FB(2) overturns the usual principle that a trustee who appoints an agent, provided the trustee acts with requisite care in selecting and supervising the agent, is not liable for losses incurred by the agent.[18] The section is intended to override inconsistent provisions in the State and Territory Trustee Acts, e.g. *Trustee Act 1958* (Vic) sec 36 and *Trustee Act 1925* (NSW) sec 59.[19]

15. ASIC Policy Statement 133.20(e).
16. ASIC Policy Statement 133.25.
17. Explanatory Memorandum para 8.6.
18. *Re Speight* (1883) 22 Ch D 727.
19. Explanatory Memorandum para 8.7.

Sub-agents are dealt with under sec 601FB(3), which provides that sub-agents are to be treated as being agents appointed by the responsible entity under subsection (2).

Section 601FB can be seen to be at the heart of the "single responsible entity" concept contained in Chapter 5C. In its report on the bill tabled in March 1998, the Joint Committee on Corporations and Securities concluded that "Investors will benefit from the clear identification of a single party responsible for all the activities and functions of the scheme. The clear and unambiguous allocation of responsibility to a single party will be made clear to both the responsible entity and the investor".[20] In seeking to fix liability for any loss caused by the responsible entity, its agents or appointees on the responsible entity, sec 601FB works in conjunction with sec 601MA, which confers on members a statutory right of action against the responsible entity.

There may be some uncertainty over the proper application of the section in circumstances where the responsible entity was required, rather than chose, to engage the agent. Under ASIC Policy Statement 133 on scheme property arrangements, many responsible entities will be required as a condition of their licence or pursuant to their compliance plan to appoint a custodian to hold scheme property. Responsible entities of schemes in existence prior to 1 July 1998 may have been directed by members to appoint a custodian under the transitional procedures in sec 1457. Where the responsible entity is in this position, it is not clear whether it is liable for the acts or omissions of the custodian under sec 601FB(2). Arguably sec 601FB(2) can be interpreted as applying only in relation to acts or omissions of agents acting under the appointment or engagement made by the responsible entity exercising its power under the section. That power is limited to a power in relation to "anything that [the responsible entity] is authorised to do in connection with the scheme". Where a custodian is required by ASIC or by direction of the members, the responsible entity is not authorised to hold scheme assets itself.

Position of the agent

Generally speaking, the role and duties of the agent will be specified in the agency agreement and determined by the general law of agency. The relationship is between the agent and the responsible entity, not the scheme members. Where the agent is a custodian, the terms of the agency agreement will be prescribed to some degree by ASIC Policy Statement 133.20.

The Corporations Law does impose some obligations and disabilities on agents of responsible entities directly. Regulation 5C.7.01 prohibits self-dealing by an agent of, or other person engaged by, a responsible entity, and is discussed below. Under reg 5C.4.02 and 5C.5.01 agents are required to cooperate with compliance monitoring by the compliance plan auditor and the compliance committee.

Where the responsible entity is a trustee, it may be that its agents are subject to the same disabilities as the trustee in relation to dealings with trust property. In *ASC* v *AS Nominees Ltd* Finn J noted that:

20. Joint Committee on Corporations and Securities Majority Report (March 1998) para 1.37.

> it is . . . not open to doubt that some at least of the disabilities fiduciary law imposes on a fiduciary (including a trust company) are imposed as well on officers, employees and agents of that fiduciary. A simple example is the rule in *Ex parte James* (1803) 8 Ves 337; 32 ER 385 proscribing the purchase of trust property: see eg *Re James; Bagot's Executor and Trustee Co Ltd* v *McGregor* [1949] SASR 143.[21]

It may be that, under trust law principles, the agent assumes direct obligations to the beneficiaries in certain circumstances.[22]

Temporary responsible entities

As noted above, in some circumstances the scheme's responsible entity will be a temporary responsible entity appointed in accordance with Chapter 5C. The circumstances in which a temporary responsible entity may be appointed are discussed in Chapter 4 above.

A temporary responsible entity has specific statutory functions to perform. They are:

- to call a meeting of members "as soon as practicable and in any event within three months" of its appointment to choose a new responsible entity by extraordinary resolution.[23] The temporary responsible entity may call more than one meeting if this is required, and may apply for an extension of time if required.[24] The proposed responsible entity must meet the requirements of sec 601FA and have consented to act, and can be the temporary responsible entity provided it meets these criteria
- if the members choose a new responsible entity, to notify ASIC as soon as practicable of that fact, and
- if the members do not choose a new responsible entity or no meeting is held within the relevant period, to make application to the Court to wind up the scheme.

Section 601FQ(1) states that the temporary responsible entity "must" call a meeting and put to the members a resolution to appoint a new responsible entity. This may create problems for the temporary responsible entity where there is no suitably qualified company prepared to act in this capacity. In these situations, where the temporary responsible entity has no suitable candidate to put before the members, it would appear to be impossible for the temporary responsible entity to comply with its obligation under sec 601FQ(1). This situation appears to be contemplated by sec 601FQ(5), under which the responsible entity is required to approach the Court for a winding up order if no meeting has been held. However it does raise the question: to what extent does sec 601FQ impose a positive obligation on a temporary responsible entity to seek out a new responsible entity? At whose cost? To overcome any problems this may cause, it would be prudent to seek appropriate orders from the Court under sec 601FP(2) as to these matters when the temporary responsible entity is appointed.

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21. (1995) 18 ACSR 459, 474–5 (Federal Court of Australia, Finn J).
22. See Ford and Hardingham 60.
23. Section 601FQ(1).
24. Section 601FQ(2).

Duties of the responsible entity

The sources of the responsible entity's powers and duties in relation to the scheme are threefold:

- the Corporations Law
- the general law, and
- the scheme constitution.

Therefore the nature of those powers and duties depends in part on identifying the nature of the relationship between the responsible entity and the members. The nature of that relationship is significant not only in determining the responsible entity's powers and duties under the general law, but also in interpreting the provisions of Division 1 of Part 5C.3. In most (if not all) cases, the responsible entity will be in a fiduciary relationship with the members (even if the scheme does not appear to be structured as a trust).[25]

Section 601FC imposes duties on the responsible entity that can be divided into the following broad classes:

- fiduciary type duties (sec 601FC(1)(a), (c)–(e) and (i))
- duty of care (sec 601FC(1)(b))
- duty to comply with law and documents (sec 601FC(1)(f)–(h), (k) and (m))
- other duties and disabilities (sec 601FC(1)(j) and (l), sec 601FC(4) and sec 601FG).

The duties set out in sec 601FC(1) apply to the responsible entity "in exercising its powers and carrying out its duties". Presumably the reference here is to the responsible entity's powers and duties as a responsible entity, although the section itself is silent in this regard. The Explanatory Memorandum states that the duties "reflect both the fundamental duties of a fiduciary, as well as certain of the duties currently imposed on the management company and trustee under the covenant provisions of Division 5 of Part 7.12 of the Law".[26]

Where the responsible entity, on the particular facts of the scheme in question, is in a fiduciary relationship with the scheme members, its fiduciary duties will co-exist with the statutory duties. Where the responsible entity holds scheme property and is therefore a trustee for scheme members under sec 601FC(2), the responsible entity will owe to the scheme members the duties of a trustee. Where the responsible entity is in a fiduciary relationship with the members but is not a trustee for them, the scope of its fiduciary duties will be determined by the nature of the relationship between them.

That the responsible entity's statutory duties under sec 601FC coexist with its general law duties is consistent with the approach taken by the courts to sec 232 of the Corporations Law. The statutory duties imposed on company officers under sec 232 coexist with,

25. See Kam Fan Sin 170-3.

26. Explanatory Memorandum para 8.8.

and do not replace or wholly codify, the fiduciary duties owed by those officers under general law.[27]

Two important observations can be made about the relationship between the fiduciary duties and the statutory duties:

- if the fiduciary duty is more extensive than the statutory duty, then except to the extent that the fiduciary duty is limited or excluded by the constitution of the scheme, it will continue to apply, and
- the constitution can limit or modify the fiduciary duties, but cannot limit or exclude the statutory duties.

For many schemes, the responsible entity will wish to exclude, to the maximum extent possible, the duties imposed under the general law, including both the fiduciary duties and, where relevant, the duties imposed on trustees by relevant State and Territory *Trustee Acts.*

As a general proposition it would appear that the powers, duties and discretions of a trustee can be modified in the trust instrument. The authors of *Jacobs' Law of Trusts* note that:

> a settlor or testator can amend, alter or modify any of the powers, duties and discretions which would otherwise apply. He can also determine what consequences flow from a breach of duty. Just as the law of contract permits the parties to a contract to determine its terms, subject to any relevant legislation, the law of trusts permits the settlor or testator to determine the incidents of the trust."[28]

Therefore, the authors conclude, "the express words of a trust instrument may absolve a trustee from performance of what would otherwise be his duty".[29] For the most part, duties imposed by trustees under the State and Territory *Trustee Acts* may be excluded also, although this depends upon the particular words of the statute. For example, sec 7(1) the Victorian *Trustee Act 1958* provides that any rules or principles of law or equity that impose a duty on a trustee exercising a power of investment[30] apply "except to the extent that they are inconsistent with . . . the instrument creating the trust".

The statutory duties were included on the recommendation of ALRC/CASAC in *Report No 65.* The terms of the recommendation support the view that the statutory

27. See Ford, Austin and Ramsay [8.010]. The view that the statutory duties are to "reflect or supplement duties imposed by the general law" is supported by ALRC/CASAC *Report No 65* para 10.6. The Report goes on to provide that "these [statutory] obligations should be in addition to the duties scheme operators owe to investors at general law": para 10.6.

28. *Jacobs' Law of Trusts* [1619].

29. Ibid.

30. Examples of these rules or principles given by that Act in sec 7 are "a duty to exercise the powers of a trustee in the best interests of all present and future beneficiaries of the trust, a duty to invest trust funds in investments that are not speculative, a duty to act impartially towards beneficiaries and between different classes of beneficiaries, and a duty to take advice".

duties cannot be excluded by the scheme constitution.[31] This is consistent with the view taken, in a similar context, by the authors of *Jacobs' Law of Trusts*.[32]

Statutory duties override sec 232

Section 601FC(3) provides that "a duty of the responsible entity under subsection (1) or (2) overrides any conflicting duty an officer or employee of the responsible entity has under sec 232". It appears that the intention here was that, in making a decision for example to prefer the interest of scheme investors over the interests of the responsible entity itself, directors of the responsible entity would not be held liable for failing to give precedence to the interests of their company, as is required by sec 232 of the Corporations Law.

Inclusion of the subsection reflects an understanding that the responsible entity, as an artificial legal person, acts through the agency of its officers. Therefore its officers are required to take the actions necessary to discharge the responsible entity's statutory obligations. The draftsperson has taken the view that, in taking the actions necessary to discharge the responsible entity's statutory obligations, an officer may placed in a position where the steps taken are inconsistent with the officer's duties to the responsible entity itself under sec 232. However it is difficult to envisage a situation in which this would occur, given the "general duty of directors not to incur claims against the company's estate by improper conduct".[33]

The expression "overrides" appears to suggest that it is intended to act as a defence to liability for a claim against an officer or employee of the responsible entity arising under sec 232 of the Corporations Law, but this is not clear. Also, unlike the corresponding recommendation made in the ALRC/CASAC *Report No 65*, sec 601FC is not expressed to override all obligations owed by officers and employees to the responsible entity, only their statutory obligations.[34]

The nature of the statutory duties is discussed below. The discussion assumes that the general law duties have been excluded to the maximum permissible extent by the scheme constitution.

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31. ALRC/CASAC *Report No 65* recommends "that the Corporations Law should state clearly a set of obligations for operator and their officers which may not be modified or excluded by a scheme's constitution": para 10.6.
32. The authors state that "occasionally, legislation imposes a duty on trustees which is incapable of amendment, but this is rare. Thus, the Corporations Regulations require that the trustee of 'prescribed interests', to which Division 5 of Part 7.12 of the Corporations Law applies, exercise his powers in the best interests of his beneficiaries rather than in his own interests, and the *Superannuation Industry (Supervision) Act 1993* (Cth) requires a similar duty of the trustee of superannuation funds if they are to obtain the benefits permitted under federal revenue laws. These statutory duties could not be negatived." *Jacobs' Law of Trusts* [1619].
33. Ford Austin and Ramsay [8.110].
34. ALRC/CASAC *Report No 65* Vol. 2, draft sec 232AA(7).

The fiduciary-type duties

In exercising its powers and carrying out its duties, the responsible entity of a registered scheme must:

- act honestly (sec 601FC(1)(a))
- act in the best interests of the members and, if there is a conflict between the members' interest and its own interests, give priority to the members' interests (sec 601FC(1)(c))
- treat the members who hold interests of the same class equally and members who hold interests of different classes fairly (sec 601FC(1)(d))
- not make use of information acquired through being the responsible entity in order to:
  - gain an improper advantage for itself or another person, or
  - cause detriment to scheme members (sec 601FC(1)(e)), and
- ensure that the scheme property is:
  - clearly identified as scheme property and
  - held separately from property of the responsible entity and property of any other scheme (sec 601FC(1)(i)).

The fiduciary-type duties reflect in operation and content aspects of sec 232 of the Corporations Law, which imposes duties on company officers.

Duty of honesty

ALRC/CASAC's recommendations in *Report No 65* included a recommendation that the Corporations Law should impose an obligation on the operator of a scheme to act honestly in respect of the scheme. Such an obligation was said to be "fundamental".[35]

It seems likely that the duty of honesty imposed on responsible entities will be interpreted on a basis similar to that imposed on company officers under sec 232(2) of the Corporations Law. If so, the duty can be expressed as a duty to act in good faith in the best interests of the scheme members[36] and for a proper purpose. Breach of the section would not appear to be confined to situations where the responsible entity had a consciousness of wrongdoing. Section 601FC is a civil penalty provision, and sec 1317EA assumes that a contravention of sec 601FC can occur without knowing, intentional or reckless conduct. Accordingly it may be possible for a responsible entity to breach the duty of honesty where it has failed to act in good faith in the interests of the scheme or for a proper purpose, even where the responsible entity subjectively and honestly believed that it was acting properly.[37]

35. ALRC/CASAC *Report No 65* para 10.7.
36. To characterise the duty as one to act in the best interests of scheme members as a whole is consistent with sec 601FC(1)(c).
37. See Ford, Austin and Ramsay [8.300].

Duty to prefer member's interests

Section 601FC(1)(c) requires the responsible entity to act in the best interests of members and, if there is a conflict between the member's interests and its own interests, to give priority to the members' interests. Paragraph (c) should be read in conjunction with paragraph (a), which incorporates a requirement on the responsible entity to act in the interests of the scheme members, and paragraph (d), which contains the duty of impartiality.

In its *Report No 65,* ALRC/CASAC stated that:

> Investors in collective investment schemes rely heavily on the operator to act in their best interests. Nevertheless, there will often be a potential for conflict between their interests and those of the operator. This may arise over the fees and charges payable to the operator or the use of scheme property for dealings with parties related to the operator. [Discussion Paper] 53 proposed that the law should impose on operators a duty to avoid conflicts of interest. A number of submissions argued that this proposal was neither realistic nor desirable. Conflicts of interest between scheme operators and investors are inevitable. The Review has concluded that the appropriate formulation of the test is that operators must prefer the interests of investors over their own interests where any conflicts arise.[38]

ALRC/CASAC had recommended that the duty be formulated to require the responsible entity to prefer the interests of investors over their own *and any other person's* interest where a conflict arose (emphasis added). The requirement to prefer the investor's interests over any other person's was not included in the final form of the legislation. It is not clear what the extent of the responsible entity's obligation is where the interests of members in a scheme conflict with the interests of third parties, say, investors in another scheme operated by the responsible entity.[39]

Section 601FC(1)(c) reflects in part the obligation imposed on trustees and management companies under the former reg 7.12.15(1)(f)(i) which required that they "perform their functions and exercise their powers under the deed in the best interests of all the holders of the prescribed interests and not in the interests of the [management] company or the trustee if those interests are not the same as those of the holders of the prescribed interests generally".

Duty of impartiality

Section 601FC(1)(d) requires the responsible entity to "treat the members who hold interests of the same class equally and members who hold interests of different classes fairly". It reflects in part the former reg 7.12.15(1)(f)(ii) which required the management company and the trustee to treat holders of prescribed interests of the same class equally, and holders of prescribed interests of different classes fairly. In turn it reflects the fundamental duty of impartiality as between beneficiaries that is imposed on a trustee.[40]

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38. ALRC/CASAC *Report No 65* para 10.8.
39. On balancing the interests of more than one trust, see Betts, Buchanan and Baxt *Corporate Trustees; Disclosure, Taxation and the Liability of Officers* (CCH 1979) para 334.
40. See eg *Re Lepine* [1892] 1 Ch 210 at 219 per Fry LJ.

Misuse of information

Section 601FC(1)(e) prohibits the responsible entity from making use of information acquired through being the responsible entity in order to gain an improper advantage for itself or another person or to cause detriment to the members of the scheme. Its drafting reflects in part sec 232(5) which imposes a similar duty on officers of a corporation.

It seems likely that the cases on sec 232(5) will be relevant in interpreting this duty. However note that there are differences in the drafting between the two sections. While sec 232(5) prohibits "improper use" of information to gain any advantage, sec 601FC(1)(e) prohibits any use of information to gain an improper advantage or to cause detriment. It is not clear whether this difference was intended, although it is arguable that the fact that any use, not just an improper use, of information is prohibited may mean that the prohibition extends beyond circumstances where the information was of a kind that equity would protect by injunction for breach of fiduciary duty.[41]

Obligations in relation to scheme property

Section 601FC(1)(i) requires that the responsible entity ensure that scheme property is clearly identified as such and is held separate from the property of the responsible entity and the property of any other scheme. This requirement reflects the general principle that trust funds should always be kept separate from the assets of the trustee. In its initial recommendation that such a requirement be included, ALRC/CASAC had expressly carved out schemes in which title to scheme assets remained with the investors.[42] This recommendation was not carried forward into the final form of the legislation, but presumably where title to scheme assets is retained by investors, the requirement will have no application.

The requirement to identify and hold separately the assets of the scheme is the subject of detailed ASIC policy, contained in ASIC Policy Statement 133 and discussed above. ASIC's policy is that, in most circumstances, responsible entities will be able to achieve this separation only through the use of an external custodian. Careful regard should be had to the terms of the ASIC Policy Statement in interpreting the requirements of this section. Particularly, ASIC has included in its policy guidance on matters such as the use of omnibus accounts.

It is interesting to note that, in the ALRC/CASAC recommendations, it was a defence to liability for breach of the duty to keep scheme property separate from the operator's own property, and to clearly identify it as such, if the operator was taking all reasonable measures to prevent a contravention and none of its executive officers had reason to suspect that the contravention would occur.[43] There is no such defence under sec 601FC(1).

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41. See e.g. *Rosetex Co Pty Ltd* v *Licata* (1994) 12 ACSR 779.
42. ALRC/CASAC *Report No 65* para 10.11, 9.15.
43. ALRC/CASAC *Report No 65* Vol. 2, draft sec 260AB and 260 AC(1).

Duty of care and diligence

Section 601FC(1)(b) requires the responsible entity to act "with the degree of care and diligence that a reasonable person would exercise if they were in the responsible entity's position".[44] As such, the section imposes an objective measure of care and diligence, to be determined having regard to the "position" of the responsible entity. In determining the responsible entity's position, regard should be had to the nature of the responsible entity's duties under the scheme constitution, as well as the nature of the relationship between the responsible entity and the members. It may be that a responsible entity that is trustee for scheme members will be held to a higher standard of care and diligence than one that is in a contractual relationship.

It should be noted that, unlike sec 232(4) of the Corporations Law, sec 601FC(1)(b) does not require that the circumstances of the scheme be taken into account. The Explanatory Memorandum to the Corporate Law Reform Bill 1992, by which sec 232(4) in its current form was introduced into the Corporations Law, stated that the requirement that the standard of care be measured in light of the corporation's circumstances meant that the duty "will be influenced by matters such as the state of the corporation's financial affairs, the size and nature of the corporation, the urgency and magnitude of any problem, the provisions of the corporation's constitution, and the composition of its board". The fact that the words "the scheme's circumstances" have not been included in sec 601FC(1)(b) suggests that these matters are not to be taken into account in determining the scope of the duty.

In the case of scheme that are trusts, the position of the responsible entity is that of trustee. As such, a special standard of care applies. That standard was examined in the context of a commercial, publicly offered investment trust by Finn J in *ASC* v *AS Nominees Ltd*.[45] His Honour concluded that, at least, the standard was that of an ordinary, prudent business person conducting the business as if it were his or her own, subject to a "gloss on (or adjunct to) this in relation to trustee investments which is aptly described . . . as the 'requirement of caution'."[46]

Applying the requirement of caution can be problematic in the context of speculative, commercial enterprises such as public investment trusts. The question of whether caution in investment selection and management is required of trustees of public investment trusts, even where the intention of the members was that they be operated in an entrepreneurial or speculative manner, is difficult. While the terms of the scheme constitution itself may permit speculative investments,[47] it would appear that the responsible entity's power to invest in such investments must be exercised prudently.[48]

44. A statutory duty of care was not among the ALRC/CASAC recommendations.

45. (1995) 18 ACSR 459

46. Ibid 469. See also *Jacobs' Law of Trusts* [1718].

47. The authors of *Jacobs' Law of Trusts* note that "it is . . . clear that the trust instrument could, if suitably worded, authorise the investment of trust moneys in hazardous, speculative, wasting or mining investments, which would otherwise be a breach of trust": [1619].

48. Ibid [1806].

In *ASC* v *AS Nominees*, Finn J applied the requirement of caution in the context of a publicly offered investment trust (in this case, a superannuation trust). In explaining the requirement of caution he refers with approval to the following passage in *King* v *Talbot*:

> It . . . does not follow, that, because prudent men may, and often do, conduct their own affairs with the hope of growing rich, and therein take the hazard of adventures which they deem hopeful, trustees may do the same; the preservation of the fund, and the procurement of a just income therefrom, are primary objects of the creation of the trust itself, and are to be primarily regarded.[49]

He also refers to the statement of Clarke and Sheller JA in *Daniels* v *Anderson* that "while the duty of a trustee is to exercise a degree of restraint and conservatism in investment judgments, the duty of a director may be to display entrepreneurial flair and accept commercial risks to produce a sufficient return on the capital invested".[50] Finn J adds that:

> underlying the distinction today is, probably, not merely an historical assumption about the separate purposes of companies and of trusts, but also a generalisation about the different risks that persons who invest their assets in companies on the one hand and in trusts on the other are considered likely to have assumed: for an example of risk assumption applied to trusts see *Space Investments Ltd* v *Canadian Imperial Bank of Commerce Trust Co (Bahamas) Ltd* [1986] 1 WLR 1072.[51]

To the extent that the requirement of caution applies in the context of public investment trusts, perhaps it can be seen to take its shape and context from the investment policy of the trust set out in the prospectus or otherwise notified to members under the scheme's periodic reporting or continuous disclosure obligations.

So the minimum standard of care imposed on the responsible entity of a trust based scheme is that of a ordinary, prudent business person in the management of their own affairs, overlaid with a requirement of caution. Finn J goes further in *ASC* v *AS Nominees*, to suggest that the standard of care required of trustees may be higher in public investment trusts that are operated by corporate or professional trustees "which hold themselves out as having a special or particular knowledge, skill and experience, and which directly or indirectly invite reliance upon themselves by members of the public in virtue of the knowledge etc they appear to so have".[52] Although he was not required to do so in the context of the facts before him, he indicated that he would "be prepared to apply to the trustee companies in these proceedings a standard of care higher than that of the ordinary prudent business person". Under this higher standard "a professional corporate trustee is liable for breach of trust if loss is caused to the trust fund because it neglects to exercise the special care and skill which it professes to have".[53]

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49. 40 NY 76 (1869).
50. (1995) 16 ACSR 607, 658.
51. (1995) 18 ACSR 459, 470.
52. Ibid 471.
53. Ibid 470, citing with approval the statement of Brightman J in *Bartlett* v *Barclays Bank Trust Co Ltd (No 1)* [1980] Ch 515 at 534. The authors of *Jacobs' Law of Trusts* take a different view: see [1718].

Compliance with law and documents

Section 601FC(1) goes on to require that, in exercising its powers and carrying out its duties, the responsible entity of a registered scheme must:

- ensure that the scheme's constitution meets the requirements of sec 601GA and 601GB (sec 601FC(1)(f))
- ensure that the scheme's compliance plan meets the requirements of sec 601HA (sec 601(FC(1)(g))
- comply with the scheme's compliance plan (sec 601FC(1)(h))
- ensure that all payments out of the scheme property are made in accordance with the scheme's constitution and the Corporations Law (sec 601FC(1)(k)), and
- carry out or comply with any other duty, not inconsistent with the Corporations Law, that is conferred on the responsible entity by the scheme's constitution (sec 601FC(1)(m)).

Other than a duty reflecting, in part, that contained in sec 601FC(1)(k), these duties were not among the ALRC/CASAC recommendations. Section 601FC(1)(m) is included directly against ALRC/CASAC's recommendation.[54]

Each of these obligations reiterates an existing legal obligation owed by the responsible entity. Their inclusion here is significant because the effect of each individual requirement is to make the obligation that is repeated one to which the civil penalty provisions in Part 9.4B of the Corporations Law apply.

The compliance plan

Section 601FC(1)(g) requires that the responsible entity "ensure" that the scheme's compliance plan meets the requirements of sec 601HA. The content requirements in sec 601HA are discussed in Chapter 3 above. Given that reasonable care is not a defence under sec 601FC(1)(h), it is significant that the compliance plan is expressed in sec 601HA to be required to contain "adequate measures that the responsible entity is to apply in operating the scheme to ensure compliance with this Law and the scheme's constitution". Failure to 'ensure' that the measures are adequate will expose the responsible entity to the civil penalty provisions of Part 9.4B of the Corporations Law.

Section 601FC(1)(h) requires that the responsible entity "comply with the scheme's compliance plan". The effect of this paragraph is far-reaching. It means that any failure by the responsible entity to comply with the compliance plan is a breach of sec 601FC and exposes the responsible entity to the relevant criminal and civil sanctions.

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54. ALRC/CASAC recommended that the scheme operator be subject to statutory duties to act honestly, to act in the interests of investors, not to make payments out of scheme property on account of expenses or charges, either for itself or for anyone else, except in accordance with the constitution, to keep scheme property separate from its own property, to treat investors equally and fairly and not to make improper use of information or position: *Report No 65* para 10.7–10.14.

In practice, this means that any arrangement described or set out in the compliance plan has, in effect, force of law, as if that matter had been specified in the Corporations Law itself.

The requirement to have a formal compliance plan and to comply with it was introduced first into the regulatory structure by the 1995 Bill. A compliance plan having force of law was not among the recommendations of ALRC/CASAC. Instead, ALRC/CASAC had recommended that having a compliance plan be a condition of obtaining a licence, and that compliance with a compliance plan be a defence to most prosecutions for breaches of the law.[55] Making the compliance plan a source of positive legal obligations, rather than a licence condition and a shield against liability, is a significant departure from the ALRC/CASAC recommendations.

Note that, unlike sec 601FC(1)(m), the duty to comply with the compliance plan is not limited to those provisions of the plan that are not inconsistent with the Corporations Law. However it seems that paragraph (h) should be interpreted in this way.

The constitution

Section 601FC(1)(f) requires that the responsible entity "ensure" that the scheme's constitution meets the requirements of sec 601GA and 601GB. Those requirements are discussed in Chapter 3 above. If the responsible entity fails to ensure that, for example, the provision made in accordance with sec 601GA(1) is "adequate", or that the constitution is legally enforceable as is required by sec 601GB, the responsible entity breaches sec 601FC which is a civil penalty provision as defined by sec 1317DA. This means that civil and criminal sanctions may apply to the contravention. It is not a defence to liability that the responsible entity has taken all reasonable steps to prevent a contravention.[56]

Section 601FC(1)(m) requires that the responsible entity carry out or comply with any other duty, not inconsistent with the Corporations Law, that is conferred on the responsible entity by the scheme's constitution. This means that breach of any of the provisions of the constitution that impose a duty on the responsible entity, other than those that are inconsistent with the Corporations Law, is a breach of the Corporations Law itself.

The inclusion of paragraph (m) is directly against the recommendation of ALRC/CASAC. The proposal to make compliance with the constitution a requirement of the statute was suggested in *Discussion Paper 53*, but rejected by ALRC/CASAC in *Report No 65*. The Report notes that:

> [T]he review no longer considers. . . that it is appropriate to place this obligation in statute. Breach of the scheme constitution should not be an offence because it is inappropriate to have [ASIC] prosecuting breaches of a private agreement. Including in the Law the obligation to observe the scheme constitution is not necessary to enable investors to enforce the constitution. Investors will be able to enforce the constitution at general law. [ASIC] will also be able to enforce a scheme constitution either by representative action or by seeking a compliance order from the

55. ALRC/CASAC *Report No 65* paras 9.4–9.7.
56. Although this may be relevant for the purposes of exoneration by the court under sec 1317JA.

court. The review does not recommend, therefore, that the Corporations Law should expressly impose an obligation on a scheme operator to adhere to the scheme's constitution.[57]

Payments

Section 601FC(1)(k) requires the responsible entity to "ensure" that all payments out of the scheme property are made in accordance with the scheme's constitution and the Corporations Law. Again, reasonable care is not a defence. This means that if any payment is made otherwise than in accordance with the requirements of the constitution and the Law, the responsible entity breaches sec 601FC regardless of whether it has taken all possible steps to prevent the breach.[58]

Other statutory duties and disabilities

Section 601FC(1) also imposes duties on the responsible entity to value scheme property, and to report to ASIC certain breaches of its obligations. Section 601FC(4) imposes a limitation on the responsible entity's investment power, by prohibiting investments in unregistered managed investment schemes. Section 601FG imposes certain requirements in relation to the acquisition by the responsible entity of interests in the scheme.

Valuation

Section 601FC(1)(j) imposes an obligation on the responsible entity to "ensure" that the scheme property is valued at regular intervals appropriate to the nature of the property. "Scheme property" is defined in sec 9.

ASIC has indicated in its Policy Statement 132 that details of the proposed valuation frequency and procedures must be included in the scheme's compliance plan. Where provisions are included in the constitution for calculating the issue or withdrawal price for interests, and those prices depend on the value of scheme assets, the basis on which the value is calculated must be included in the constitution itself.[59]

Duty to report breaches to ASIC

Section 601FC(1)(l) imposes on the responsible entity a duty to report to ASIC any breach of the Corporations Law that relates to the scheme and that has had, or is likely to have, a materially adverse effect on the interests of members, as soon as practicable after it

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57. Ibid para 10.14.

58. ALRC/CASAC recommendations had include a provision that "the operator of a collective investment scheme contravenes this section if property of the scheme is used or applied to pay for fees, charges or expenses incurred in connection with the scheme (including its own fees or charges) contrary to the constitution of the scheme". However it was a defence if, at the time the contravention occurred, the operator was "taking all reasonable measures to prevent contraventions of the relevant kind and none of the executive officers of the [operator] had reason to suspect that the contravention would occur": ALRC/CASAC *Report No 65* Vol. 2, draft sec 260AK.

59. See Chapter 3 above.

becomes aware of the breach. The reference to "interests" of members appears to suggest that the effect on their economic, as well as legal, position is to be taken into account. As to what constitutes a "materially adverse effect" for these purposes, case law may be required.

The responsible entity's reporting obligation under this section is in addition to its obligations under the licensing provisions in Part 7.3 of the Corporations Law.

Investing in unregistered managed investment schemes

Section 601FC(4) provides that the responsible entity may only invest scheme property, or keep scheme property invested, in another managed investment scheme if that other scheme is registered under Chapter 5C.

In intent, the subsection is derived from the former reg 7.12.15(1)(a).

Careful regard must be had to the definition of managed investment scheme in applying this section. It is important to note that responsible entities are prohibited from investing scheme property in any scheme that falls within the definition of managed investment scheme, even where the latter scheme is not otherwise required to be registered under sec 601ED. In particular, note that the prohibition will extend to schemes that are managed investment schemes but in respect of which Chapter 5C does not apply by operation of reg 5C.11.01 or as a result of an ASIC exemption. This is because sec 601FC(4) imposes an obligation on the investing scheme; the fact that the scheme in which funds are invested is not subject to Chapter 5C does not affect that obligation.

Accordingly, wholesale schemes may require registration if retail schemes are to invest in them. However ASIC has granted various exemptions from sec 601FC in relation to particular wholesale schemes.[60]

Note that sub-trusts, in which the responsible entity is both the sole investor in, and the operator of, that sub-trust, are not affected by this requirement. This is because sub-trusts are not "managed investment schemes" as defined, because the only investor in sub-trusts is also the person who controls its day-to-day operations, taking it outside the definition of managed investment scheme.[61]

Acquisition of scheme interests by the responsible entity

Section 601FG recognises that a responsible entity may itself be a member of a scheme operated by it. The section provides that the responsible entity may:

> acquire and hold an interest in the scheme, but it must only do so:
> (a) for not less than the consideration that would be payable if the interest were acquired by another person; and
> (b) subject to terms and conditions that would not disadvantage other members.

The section is a civil penalty provision under sec 1317DA.

60. ASIC Class Order 98/55; ASIC Policy Statement 136.23–26.
61. ASIC Policy Statement 136.57.

The section would appear to overlap to some extent with sec 601FC(1)(c), that requires the responsible entity to act in the interests of members, and to prefer members' interests of its own in the event of a conflict, and the provisions of Part 5C.7 and reg 5C.7.01, dealing with related party transactions.

Interests held by the responsible entity cannot be voted in certain circumstances.[62]

Consequences of a breach of duty

It was noted above that the statutory duties in sec 601FC(1) coexist with the fiduciary duties owed, in many cases, by the responsible entity as trustee. The duty of care in sec 601FC(1)(b) coexists with the duty of care owed by the responsible entity at common law. Where conduct in breach of the statutory duty also breaches the general law duties, the scheme member will have general law remedies available to them.

This discussion concentrates on the consequences of a breach by the responsible entity of sec 601FC(1).

Part 9.4B

Section 601FC(1) is a civil penalty provision.[63] Accordingly, where there is a breach of sec 601FC(1), the consequences in Part 9.4B attach. A civil penalty order may be made against the defaulting person or, where the requisite degree of scienter is present, the person may be convicted of a criminal offence. Orders that the person compensate the scheme may be made in connection with the civil penalty or criminal proceedings. In addition, the person may be ordered under separate proceedings to account to the scheme for any profit made or for an amount equal to any loss or damage sustained. The court has power to relieve the person from civil liability where the person has acted honestly and it appears to the court that, in all the circumstances, the person ought fairly to be excused.[64]

Note that acts and omissions of the responsible entity's agents may be imputed to the responsible entity for the purpose of determining whether "there is a liability to the members".[65] The agent's acts would not be imputed to the responsible entity for the purposes of civil penalty or criminal proceedings, although this may occur in connection with an action under sec 601HD.

Any person "involved in a contravention" by the responsible entity of sec 601FC is treated as having contravened the provision.[66] The implications of this for officers and employees of responsible entities are explored in Chapter 7 below.

62. See sec 253E.
63. Section 1317DA.
64. Section 1317JA.
65. Section 601FB(2)(a).
66. Section 1317DB.

The decision to make sec 601FC a civil penalty provision is directly contrary to the recommendation of ALRC/CASAC, which felt that the civil penalty regime was inappropriate for breaches of duty by corporations, rather than individuals.[67]

Civil liability

Contravention of sec 601FC may attract civil liability under sec 601MA. Section 601MA is discussed in Chapter 8 below. It may be that sec 601MA can be used only where the company in breach is the "responsible entity" at the time the proceedings are commenced.

Significantly, sec 1325 applies in relation contraventions of Chapter 5C, by operation of reg 5C.11.07. Section 1325(2) gives standing to a person who has suffered, or is likely to suffer, loss or damage because of conduct engaged in in contravention of Chapter 5C to apply for relief under the terms of that section. Orders may be made against the person who engaged in the contravention and any person involved in the contravention.

Section 1325 is wider than sec 601MA, and there is no requirement that the person contravening be the responsible entity at the time the proceedings are commenced.

Section 1324 gives a person whose interests have been, are or would be affected by a contravention of the Corporations Law standing to seek injunctive relief. Damages may be ordered under sec 1324(10). A scheme member is likely to have standing under this section in respect of a breach of duty by the responsible entity.[68]

Acts or omissions of any agents or appointees of the responsible entity are attributed to the responsible entity under sec 601FB(2)(a) for the purposes of determining whether there is a liability to the members.

Restrictions on self dealing

The statutory duties owed by the responsible entity under Division 1 of Part 5C.2 are supplemented by restrictions on related party transactions contained in Part 5C.7 and reg 5C.7.01. This is done by regulating the terms on which certain "financial benefits" may conferred by the responsible entity, its child entities and its agents on themselves and their respective related parties.

The drafting of Part 5C.7 and reg 5C.7.01, and their relationship with each other and with the statutory duties contained in Part 5C.2, is extremely problematic in many respects. Considerable care should be taken in relation to any form of self-dealing involving scheme property. In particular, it should be noted that reg 5C.7.01 may be wider in operation than Part 5C.7, and it should not be assumed that a transaction permitted under Part 2E.4 or 2E.5 will be allowed to proceed in all circumstances.

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67. ALRC/CASAC *Report No 65* examines "the question . . . [of] whether the civil penalty regime should be applied to the operator itself (the company) in relation to a breach by it of its obligations to investors. The Review *recommends* that it not apply. The regime was designed in the context of breach by individuals of duties that they owe as individuals. It was not designed for breaches by bodies corporate": para 15.11.

68. See *BHP Co Ltd* v *Bell Resources Ltd* (1984) 2 ACLC 157, 162 and Ford and Hardingham 68.

Part 5C.7

Part 5C.7 purports to apply the former Part 3.2A, governing transactions by public companies and their child entities with related parties of the public company, to registered schemes.[69] Note that sec 601LA refers to Part 3.2A, not Chapter 2E. Part 3.2A was renumbered as Chapter 2E by the *Company Law Review Act 1998*, which commenced before the *Managed Investments Act 1998*, but the *Managed Investments Act 1998* did not take account of the renumbering.

Part 5C.7 was amended in the Senate, and is in a slightly different form from that proposed in the bill.

Object of the Part

The object of the Part as it applies to registered schemes is "to protect the scheme property for the benefit of members by requiring that, in general, financial benefits to the responsible entity or its related parties that could diminish or endanger scheme property, or that could adversely affect the interests of members, must be disclosed and approved by a members' meeting, before they are given.".[70]

This object is achieved through a prohibition, contained in sec 243H as modified by sec 601LC, on the responsible entity or a child entity of the responsible entity giving a financial benefit out of scheme property, or that diminishes or endangers scheme property, unless one of the general exceptions in Part 2E.4 applies or member approval has been given in accordance with Part 2E.5. However the prohibition does not prevent the responsible entity from paying itself fees and exercising rights to an indemnity as provided for in the scheme's constitution under sec 601GA(2).[71]

Whether the Part is effective in realising that purpose will depend in part on the approach taken by the courts to its drafting. If the court gives precedence to the objects section in interpreting Chapter 2E as modified in Part 5C.7, some of the more obvious defects in its drafting may be overcome.

One particular issue to be resolved concerns the relationship between Part 5C.7 and other parts of the Chapter. For example, under Part 5C.7, a responsible entity is permitted to confer a financial benefit on itself other than on arm's length terms, with member approval. However the responsible entity is prohibited by sec 601FC(1) from preferring its own interests to those of the members of the scheme. It seems unlikely that shareholder approval given in accordance with Part 2E.5 will override the responsible entity's obligations under sec 601FC(1), to the detriment of dissenting members.[72]

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69. For commentary on Chapter 2E generally, see Pamela Hanrahan "Transactions with Related Parties by Public Companies and their Child Entities under Part 3.2A of the Corporations Law" (1994) 12 *Company and Securities Law Journal* 138.
70. Section 243A as modified by sec 601LB.
71. Section 243H(3) as modified by sec 601LC.
72. The authors of *Jacobs' Law of Trusts* note that it is "clear law that the persons to whom a fiduciary duty is owed may excuse their fiduciary of any breach of his duty which he has committed, if he makes full disclosure to them" — para [1622]. However a release given by some does not bar the others from enforcing their claims against a defaulting trustee — para [2236].

Given the very extensive obligations owed by a responsible entity to scheme members under Chapter 5C, it seems that the types of transactions requiring shareholder approval under Part 2E.5, as modified by Part 5C.7, may frequently be open to challenge by dissenting members.

The further difficulty in interpreting the Part lies in the relationship between Part 5C.7 and reg 5C.7.01, discussed below.

The prohibition

Section 243H, as modified by sec 601LC, prohibits certain conduct by the responsible entity and any child entity of the responsible entity.

Prohibition on the responsible entity conferring a financial benefit

Under sec 243H(1) as modified by sec 601LC, the responsible entity of a registered scheme is prohibited from giving "a financial benefit to itself, or to a related party:

(a) out of the scheme property; or

(b) that could diminish or endanger the scheme property

unless [Part 2E.4 or 2E.5] permits the benefit to be given".

Financial benefit

The expression "giving a financial benefit" must be interpreted in accordance with sec 243G. The expression is interpreted broadly, and includes indirect benefits. The economic and commercial substance and effect of the action prevails over its legal form in deciding whether a financial benefit has been given.[73]

In determining whether a financial benefit has been given, any consideration that has been given is disregarded, even if it is full and adequate.[74] If full and adequate consideration has been given in return for a benefit, it may be that the benefit could not diminish or endanger scheme property, and accordingly would not contravene sec 243H(1)(b). Also, adequate consideration may be evidence of "arm's length terms", bringing the transaction within the general exception in sec 243N.

Related party

"Related party" of the responsible entity is interpreted in accordance with sec 243F, as modified by sec 601LA. It includes:

- a director of the responsible entity or a parent entity of the responsible entity, certain close relatives of a director, and certain entities controlled by a director

73. Section 243G(2)(a).
74. Section 243G(2).

- any one of the persons constituting an entity (other than a body corporate) that is a parent entity of the responsible entity and entities controlled by that person and, if that person is a natural person, certain of their close relatives
- a parent or sibling entity of the responsible entity.

Note that the definition does not include a child entity of the responsible entity, such as a subsidiary. However if a responsible entity were to confer a benefit on a child entity, it is likely that it would be viewed as having also conferred a benefit on itself.

From or affecting scheme property

A financial benefit is only prohibited by sec 243H(1)(a) if it "comes out of scheme property". "Scheme property" is defined in sec 9.

The expression "diminish or endanger scheme property" is not defined. Possibly a transaction "diminishes" scheme property if the consideration received by the scheme does not represent full and adequate value. For example, a transaction in which the scheme paid $100 to acquire property or services worth $80 "diminishes" scheme property.

This analysis may suggest that a transaction on arm's length terms is unlikely to diminish scheme property.

The reference to "endangering" scheme property is curious. If endanger means put at risk of loss or diminution then arguably any investment that is not entirely risk free would meet this test.

Prohibition on a child entity of the responsible entity conferring a financial benefit

Section 243H(2) prohibits a child entity of the responsible entity from giving a financial benefit to itself, or the responsible entity, or to a related party of the responsible entity, out of the scheme property, or that could diminish or endanger scheme property, unless Part 2E.5 or 2E.6 permits the benefit to be given.

Child entity is defined in sec 243D of the Corporations Law. Any subsidiary of the responsible entity, and any entity over which it has control within the meaning of sec 9, is a child entity of the responsible entity.

The inclusion of sec 243H(2), as modified by sec 601LC, represents little other than a fundamental misunderstanding of the purpose and operation of Chapter 2E. The reason why certain related party transactions are prohibited for child entities of public companies is that the adverse impact of the transaction on the value of the child entity impacts on the public company shareholders through a reduction of the value of the parent's interest in the child entity. This reasoning has no application in the context of managed investment schemes. A transaction that impacts adversely on the value of a child entity of a scheme's responsible entity harms the shareholders in the responsible entity, not the members of the scheme.

It is noted that sec 243H(2) is drafted to apply only to transactions by the child entity out of scheme assets or diminishing or endangering scheme property. However it is not clear when or why a child entity of a responsible entity would be in possession of, or have access to, scheme assets or be a position to enter into arrangements that impact on scheme assets. As the responsible entity is the person who is required to hold scheme assets and operate the scheme, why would its child entity be in this position? If the child entity is acting as agent of the responsible entity, its acts or omissions will be imputed to the responsible entity under sec 601FB(2) for the purpose of determining any liability to scheme members, and the prohibition in reg 5C.7.01 will apply by operation of reg 5C.7.01(1)(c).

Exceptions to the prohibition

A responsible entity is not prohibited by sec 243H from paying itself fees, and exercising rights to an indemnity, as provided for in the scheme's constitution under sec 601GA(2).[75]

A responsible entity and its child entities are not prohibited by sec 243H from:

- giving a financial benefit as required by a contract made before 1 July 1998 (sec 243J and reg 5C.11.05)
- paying reasonable remuneration to its officers (sec 243K)
- giving a financial benefit on arm's length terms (sec 243N)
- giving financial benefits to members of the scheme, in their capacity as such and on a non-discriminatory basis (sec 243PA as modified by sec 601LA(e))
- giving a financial benefit under a court order (sec 243PB)
- giving a financial benefit that is approved by scheme members in accordance with the requirements of Part 2E.5.

In proposing to give a financial benefit of any kind to any person, the responsible entity should always have regard to its duties under sec 601FC.

In relation to sec 243K, it is not clear why such remuneration would come from or diminish or endanger scheme property, unless payment of such remuneration was provided for in the constitution under sec 601GA(2) and therefore permitted under sec 243H(3).

Note that, in relation to member approval under Part 2E.5, the restrictions on voting by interested parties contained in sec 243ZB(1) are modified by sec 601LE.

Consequences of a breach

If the responsible entity or a related party of the responsible entity has received a financial benefit, and, in conferring the benefit, the responsible entity or its child entity breached sec 243H(1) or (2), the related party and any person "involved in the contravention" breach sec 243ZE(2) and (3) respectively. These provisions are civil penalty provisions.

There is no breach by the responsible entity or its child entity. This arises from an imperfect application of the principles in Part 2E.6 to managed investment schemes. The rationale, in the context of the application of Part 2E.6 to related party transactions by public companies, for providing that the public company has not committed an offence is that the public company is the person harmed by the contravening conduct. However in the

75. Section 243H(3)

context of managed investment schemes the people harmed by the contravening conduct are the members of the scheme, not the responsible entity. Therefore it seems contrary to policy to excuse the responsible entity from liability for a breach of Chapter 2E.

Regulation 5C.7.01

Regulation 5C.7.01 overlaps to a considerable extent with Part 5C.7. However the significant points of departure between the two are:

- reg 5C.7.01 extends the application of the prohibitions to agents of the responsible entity
- reg 5C.7.01 may prohibit any self-dealing that could diminish or endanger scheme property, other than payments of fees or on the exercise of a right of indemnity provided for in the constitution, even if the dealing is permitted under Part 2E.4 or approved by members under Part 2E.5, and
- the consequences of a breach of reg 5C.7.01 are different from those for a breach of Part 5C.7.

Regulation 5C.7.01 applies to:

> a financial benefit that is given out of the property of a registered scheme by a person who is:
> (a) the responsible entity of the scheme; or
> (b) an entity that the responsible entity controls; or
> (c) an agent of, or another person otherwise engaged by, the responsible entity.

Regulation 5C.7.01(2) provides that "unless [Part 2E.4 or Part 2E.5] permits the benefit to be given out of scheme property to the person or a related party, the benefit must not be given out of the property to that person or party". Regulation 5C.7.01(3) prohibits benefits "given out of scheme property to the person or a related party if the benefit could diminish or endanger scheme property or adversely affect the interests of members". However reg 5C.7.01(4) goes on to provide that reg (3) does not prevent the person or a related party from being paid fees, or exercising rights to an indemnity, in accordance with the scheme's constitution.

The regulation raises a preliminary issue of interpretation, as to the proper interrelationship between sub-regulations (2) and (3). It is possible that the intention of the draftsperson was that sub-regulation (3) contain the principle prohibition, and sub-regulation (2) the exception to it. In other words, it may be that the intention was to prohibit financial benefits only where the benefit "could diminish or endanger the scheme property or adversely affect the interests of members" (sub-regulation (3)), and then provide in sub-regulation (2) that such transactions could nevertheless proceed if they were permitted under Part 2E.4 or 2E.5 (presumably, as modified by Part 5C.7). This interpretation is supported by sub-regulation (4), which excludes fees and expenses from the prohibition in sub-regulation (3), but not from the operation of sub-regulation (2).

However, if this was the intention, it is not clear that it is achieved on the drafting. Instead, the natural meaning of the words used in sub-regulation (2) and (3), read in conjunction with sub-regulation (1), suggests that they should be read seriatim, with each containing a separate prohibition that operates independently of the other. Read this way, sub-regulation (2) provides that the benefit referred to in sub-regulation (1) must not be given unless it is permitted under Part 2E.4 or 2E.5, without limiting the benefits to which it applies. Sub-regulation (3) prohibits only those benefits that could diminish or endanger the scheme property or adversely affect the interests of members, and does not exclude from the prohibition those that are permitted under Part 2E.4 or 2E.5. The only benefits of this kind that can proceed are those saved by sub-regulation (4).

Regulation 5C.7.01 applies to a benefit given to "the person or a related party". The person to whom it applies is the responsible entity, a controlled entity of the responsible entity, or an agent of the responsible entity. The reference to 'a related party' suggests that, in each case, the prohibition only extends to the person conferring a financial benefit on themselves or their own related parties. In other words, the regulation would not to prohibit a responsible entity conferring a benefit on an agent or a related party of an agent out of scheme property, unless the related party of the agent was also a related party of the responsible entity. This is because, in each case, the sub-regulations refer to the benefit being given by a person to *the* person or a related party (emphasis added).

Regulation 5C.7.01(2) refers to benefits that are permitted under Part 2E.4 or Part 2E.5. It appears that the reference to Part 2E.4 or Part 2E.5 in the regulation should be read subject to sec 601LA, that is, as modified by the operation of Part 5C.7.

Regulation 5C.7.01(4) provides that sub-regulation (3) does not prevent the person or a related party from being paid fees, or exercising rights to an indemnity, in accordance with the scheme's constitution. However there is no such qualification to the prohibition in reg 5C.7.01(2). Arguably, this means that payments of fees and pursuant to rights of indemnity provided for in the constitution are not permitted unless they also fall within one of the exclusions in Part 2E.4 (such as payments on arm's length terms) or are separately approved by members under Part 2E.5, although this seems unlikely.

The intention in sec 243H(3) as modified by sec 601LC and reg 5C.7.01(4) appears to have been that amounts provided for in the constitution could be paid without infringing the related party transaction provisions. Therefore it may be that the failure to qualify the prohibition in this way in reg 5C.7.01(2) was unintentional.

Consequences of a breach

It is by no means clear that the enforcement regime in Part 2E.6 applies in relation to reg 5C.7.01, if indeed it was intended to do so. It seems more likely that a breach of reg 5C.7.01 would attract the general penalties regime set out in Part 9.4. References to "this Law" in the Corporations Law include reference to the regulations[76] and accordingly the provisions of Part 9.4 in particular will apply where a breach has occurred.

Unlike Part 5C.7, contravention of reg 5C.7.01 can result in liability for the responsible entity or its controlled entity itself, not just those involved in the contravention.

76. Section 8A.

Chapter 6

Compliance Monitoring

The commencement of Chapter 5C on 1 July 1998 altered the legislative requirements for compliance monitoring in relation to managed investment schemes. Under the old Law, the trustee had been required to "exercise all due diligence and vigilance in carrying out [its] functions and duties and in protecting the rights and interests" of the members[1] and to "take the reasonable steps necessary to become informed of the exercise by the [manager] of its powers, and the performance of its functions, under the deed".[2] The ASC interpreted these obligations as imposing a positive duty on trustees to watch and protect the interests of members.[3]

The new Law no longer requires the appointment of a separate trustee for members, although a custodian trustee may be required in certain circumstances.[4] Instead a procedure focusing on the monitoring and audit of compliance with a compliance plan is prescribed.

Each responsible entity is required to have, in relation to each registered scheme, a compliance plan that complies with the requirements of sec 601HA. The plan must set out adequate measures that the responsible entity is to apply in operating the scheme to ensure compliance with the Corporations Law and the scheme constitution. The requirement for, and prescribed content of, the compliance plan are discussed in Chapter 3 above.

Chapter 5C provides for the responsible entity's compliance with the plan to be audited annually by a registered company auditor. The auditor must also assess whether the plan meets the requirements of the Corporations Law.

In addition, unless at least half of the directors of the responsible entity are "external directors", the responsible entity must establish a compliance committee to monitor its compliance with the plan, and to assess the adequacy of the plan.

This chapter examines the role of the compliance plan auditor and the compliance committee members in compliance monitoring. ASIC also has a role to play in compliance monitoring, discussed in Chapter 9 below.

The compliance mechanisms provided for in Chapter 5C represent quite an interventionist approach to regulation, that focuses not only on the desired outcome but also on the process to achieve that outcome. It can be contrasted with the approach to compliance adopted under Australian law to promote good governance of companies. ASIC's power

1. Former sec 1069(1)(e)(i).
2. Former reg 7.12.15(2)(g).
3. ASC Policy Statement 89 (6 February 1995), para 22–28.
4. See ASIC Policy Statement 133.

to refuse registration to a scheme that does not have an adequate compliance plan gives the regulator considerable scope to intervene and prescribe scheme governance practices. In contrast, corporate governance practices are not prescribed by law or under ASX Listing Rules. The requirement to appoint a compliance committee where the majority of the responsible entity's directors are not external also has no counterpart in Australian company law.

The fact that a compliance committee is not required where the majority of the responsible entity's directors are external suggests that, in these circumstances, the external directors may be expected to play a role in scheme governance similar to that of the compliance committee. This suggestion is also explored below.

Audit of the compliance plan

The procedure for appointing a compliance plan auditor, and the eligibility criteria, are discussed in Chapter 3 above. Resignation and removal of the auditor are discussed in Chapter 4 above. This section examines the responsibilities and powers of the compliance plan auditor, and the process of the audit.

Role and responsibilities of the auditor

The auditor's responsibilities and powers are set out in sec 601HG. Its responsibilities are:

- to examine the compliance plan (sec 601HG(3)(a))
- to audit compliance by the responsible entity with the compliance plan (sec 601HG(3)(b)), and
- to report to the responsible entity on:
  - whether the responsible entity has complied with the plan, and
  - whether the plan meets the requirements of Part 5C.4 (sec 601HG(3)(c)).

As such, the auditor's responsibilities are fairly limited. It is not required to examine or report on compliance with the Corporations Law or the scheme constitution, although it may be requested to do so by the responsible entity under sec 601HG(9). However in the course of its audit, the auditor may discover breaches of the Corporations Law (beyond breaches of sec 601FC(1)(g) and 601FC(1)(h), on which it specifically required to report), and this may trigger a reporting obligation under sec 601HG(4), discussed below.

In meeting its obligation under sec 601HG(3)(c)(ii) to report on whether the plan continues to meet the requirements of Part 5C.4, the auditor may be required, in addition to other matters, to consider whether the plan contains "adequate measures . . . to ensure compliance with [the Corporations] Law and the scheme's constitution", as required by sec 601HA. As a result, there is a risk that the auditor is effectively being required to guarantee that the responsible entity's systems are effective to prevent non-compliance, particularly if the requirements of sec 601HA are not read down to imply some standard of reasonableness.

The auditor must complete its examination, audit and reporting within three months after the end of the scheme's financial year.[5] A copy of the auditor's report must be lodged by the responsible entity with ASIC at the same time as the scheme's financial statements.[6]

The auditor has qualified privilege with respect to statements made in the report.[7]

Duty to bring non-compliance to the attention of ASIC

If the auditor's report under sec 601HG(3) indicates non-compliance with the compliance plan, or that the plan is defective in any respect, that will come to the attention of ASIC when the report is lodged by the responsible entity under sec 601HG(7).

The auditor is under a separate obligation to notify ASIC in writing as soon as possible if it:

- has reasonable grounds to suspect that a contravention of the Corporations Law has occurred, and
- believes that the contravention has not been or will not be adequately dealt with by commenting on it in the auditor's report or bringing it to the attention of the responsible entity.[8]

Section 601HG(4) envisages that, if in the course of its (limited) investigation under sec 601HG(3) the auditor discovers a breach of the Corporations Law, the auditor's first responsibility is to bring that breach to the attention of the responsible entity. If the responsible entity takes adequate measures to deal with the breach (presumably, by making good any loss to the scheme and tightening compliance procedures to prevent recurrence), the auditor is not required to take any further action in relation to the breach, except that to the extent that it was or included a breach of sec 601FC(1)(g) or (h), in which case details of it should be included in the report under sec 601HG(3)(c).

If however the auditor believes that the responsible entity will not deal with the breach in an appropriate way, it must report to ASIC as soon as possible. The auditor has qualified privilege with respect to the notification, under sec 601HG(8).

Auditor's right of access

Section 601HG(5) gives the auditor access at all reasonable times to the books of the scheme, and the power to require officers of the responsible entity to give the auditor information and explanations for the purposes of the audit. An officer of a responsible entity must allow that access, and provide any information or explanation requested, as well as

5. Section 601HG(3).
6. Section 601HG(7).
7. Section 601HG(8).
8. Section 601HG(4).

otherwise assisting in the conduct of the audit.[9] Agents of the responsible entity and their officers must allow the auditor access to the books of the scheme, give information and explanations when requested and otherwise assist in the conduct of the audit.[10]

Role and responsibilities of the compliance committee

Unless at least half of the responsible entity's directors are external directors, the responsible entity is required under sec 601JA to establish a compliance committee for the scheme. The circumstances in which a compliance committee is required are examined in Chapter 3 above. The compliance committee must consist of at least three members, and a majority of its members must be external members. The procedure for establishing a compliance committee, and the definition of "external member", are discussed in Chapter 3 above.

The functions of the compliance committee are set out in sec 601JC. They are:

- to monitor to what extent the responsible entity complies with the scheme's compliance plan and to report on its findings to the responsible entity
- to report to the responsible entity any breach of the Corporations Law or the provisions of the scheme constitution included under sec 601GA, of which it becomes aware or that it suspects
- to report to ASIC if it is of the view that the responsible entity has not taken, or does not propose to take, appropriate action to deal with a matter so reported, and
- to assess at regular intervals the adequacy of the plan, and report to the responsible entity on that assessment and make recommendations for improvements.

The manner in which the committee performs these functions will be set out in the scheme's compliance plan. If a scheme has a compliance committee, its compliance plan must include provisions "ensuring that the compliance committee functions properly, including adequate arrangements relating to" the membership of the committee, how often it meets, its reports and recommendations and its access to accounting records and other information, and to the auditor.[11]

Subject to those arrangements, the committee may regulate its proceedings at it thinks appropriate, and may meet by use of any technology agreed to by all the members. It is required to keep minutes of meetings and records of its reports and recommendations.[12]

The responsible entity, its officers, any agents and any agents' officers must allow the compliance committee access to the books of the scheme, provide information and explanations about the scheme when requested by the committee to do so, and otherwise assist the committee in the performance of its functions.[13]

9. Section 601HG(6).
10. Regulation 5C.4.02.
11. Section 601HA(b).
12. Section 601JH.
13. Regulation 5C.5.01

The use of the expression 'monitor' in sec 601JC implies some requirement to maintain regular surveillance over the responsible entity's activities. The frequency and nature of that surveillance will depend on the nature of the scheme itself and the particular operating circumstances encountered from time to time. Arguably 'monitor' connotes something different from, and perhaps more proactive than, audit.

The committee's obligation to monitor compliance is limited to monitoring compliance with the compliance plan. However its reporting obligation extends to any breach of the Corporations Law (and is not limited to breach of the obligation to comply with the compliance plan) or of the provisions of the constitution included to satisfy the requirements of sec 601GA. In essence, the compliance committee's obligation to monitor extends only to monitoring compliance by the responsible entity with its obligations under sec 601FC(1)(h) but, if in the course of that monitoring, it becomes aware of other reportable matters, it must report them.

Note that sec 601JC(b)(ii) purports to limit the committee's obligation to report on breaches of the constitution that relate to the provisions included under sec 601GA. However breach of any provision of the constitution that is not inconsistent with the Corporations Law is itself a breach of the Corporations Law under sec 601FC(1)(m), and therefore a reportable event under sec 601JC(b).

Statements concerning the operation of the scheme made by a committee member to the responsible entity attract qualified privilege, under sec 601JE.

If the compliance committee becomes aware of, or suspects, a breach of the Corporations Law or the provisions of the constitution, it must report to the responsible entity. If the responsible entity considers that a breach has occurred that has a materially adverse effect on the interests of members, it will be required to report that breach to ASIC under sec 601FC(1)(l), and may have further reporting obligations under the terms of issue of its securities dealers licence.

If following its report to the responsible entity under sec 601JC(b), the compliance committee takes the view that the responsible entity has not taken, or does not propose to take, appropriate action to deal with the matter, it must notify ASIC. Appropriate action may, depending on the circumstances, include compensating the scheme for any loss caused by the breach, and implementing arrangements to prevent recurrence. If appropriate action is taken, the committee is not required to report the breach to ASIC.

The compliance committee's 'whistle-blower' role reflects in some respects that of the auditor of the compliance plan, discussed above.

Compliance committee members have qualified privilege in relation to statements made to ASIC concerning the operation of the scheme.[14] Note that this privilege does not extend to statements made to auditors, which may reduce the extent to which auditors and compliance committee members can work together in carrying out their supervisory functions.

The committee is also required by sec 601JC to "assess at regular intervals" whether the compliance plan is "adequate". "Adequate" is not defined for these purposes. It may be significant that the compliance committee's obligation is not expressed in terms of assessing

14. Section 601JE.

whether the compliance plan meets the requirements of sec 601HA.[15] The committee is also required to make recommendations to the responsible entity about any changes that it considers should be made to the plan, although is does not appear that the responsible entity is required to accept or act on those recommendations.

The duties of the individual members of the compliance committee, and their potential liability for breach of duty, are discussed in Chapter 7 below.

The compliance function of external directors

A compliance committee is not required where the majority of the directors of the responsible entity are external. This raises the question of whether the external directors in these circumstances are expected to play some equivalent role in relation to scheme governance to a compliance committee.

There is nothing in sec 601FD that imposes special duties on external directors in relation to the management of the scheme. Like all directors, internal or external, they are subject to a statutory duty to take all steps that a reasonable person would take to ensure compliance by the responsible entity with its obligations in relation to the scheme. At general law, they are subject to an overriding duty not to do or fail to do anything that exposes the company of which they are a director to a claim against it.

A board consisting of a majority of external directors may choose to constitute from those directors a committee of the board that monitors compliance by the responsible entity with its compliance plan and assesses the adequacy of that plan. However clearly such a committee of the board would not be required to report separately to ASIC on non-compliance — instead the board acting as a whole would cause the responsible entity itself to meet its statutory reporting obligations under sec 601FC(1)(l).

Ultimately the extent of the monitoring obligations imposed on external directors will depend upon a proper construction of their duties at general law.

It should be noted that, while compliance committees are 'scheme specific' (in the sense that a separate committee is required for each scheme), boards of directors of responsible entities may be overseeing a business involving the management of many schemes. One commentator has noted that "from a . . . governance viewpoint, it is worth considering whether it might be preferable to have a monitoring committee devoted to each scheme under operation rather than to rely on the external directors on the board of the responsible entity to carry out the monitoring role in relation to possibly many different schemes".[16]

The duties of directors of responsible entities are discussed in Chapter 7 below.

15. Contrast the obligation of compliance plan auditors under sec 601HG(3)(c)(ii).

16. Geof Stapledon "Corporate Governance of Listed Trusts" Report prepared for the Corporate Governance committee of the Australian Investment Managers' Association, November 1997.

Chapter 7

The Position of Officers, Employees and Compliance Committee Members

Under the former Divisions 5 and 5A of Part 7.12 of the Corporations Law, the trustee and the manager of a prescribed interest scheme were made subject to certain performance obligations through the statutory covenants contained in sec 1069 and the regulations made under it. However the legislation did not impose specific performance obligations on the natural persons engaged in conducting the business of the scheme, beyond those owed by them to the company of which they were an officer.

Nevertheless, those natural persons could be liable to compensate scheme members where they were "involved in a contravention" by the manager or the trustee of a statutory covenant, through former sec 1073 and sec 1005.

Broadly speaking, the approach taken under Part 7.12 was consistent with the general law, under which officers and agents of corporate trustees are not in a direct fiduciary relationship with beneficiaries of the trust. However, where there has been a breach of trust by a corporate trustee and its officers or agents have participated with the requisite degree of knowledge in the dishonest or fraudulent design of the trustee, those persons may be liable to the beneficiaries under the principle known as the second limb of *Barnes* v *Addy*.[1]

Chapter 5C alters this position. In Part 5C.2, the officers of a responsible entity are made subject to express performance obligations under sec 601FD, and sec 601FE imposes (limited) duties on employees of responsible entities. Section 601JD imposes performance obligations on members of compliance committees. In each case the relevant provision is a civil penalty provision. This means that a person contravening the provision can be the subject of civil penalty proceedings under Division 2 of Part 9.4B or criminal proceedings under Division 3 of Part 9.4B. An order that the person compensate the scheme for any loss or damage may be made as part of those proceedings, under Division 5. In addition, the responsible entity may bring proceedings for the benefit of the scheme against the person for compensation or an account of profits under sec 1317HD.

Further, sec 1324 and 1325 may give scheme members and others the right to pursue remedies for breach of the statute against those persons. This is despite the fact that the legislative intention was that scheme members' right of recourse in the case of mismanagement be limited to the responsible entity.[2]

In addition, it should be noted that the Corporations Law imposes liability on persons involved in a contravention of the provisions of Chapter 5C (in particular, under sec 1325 and, in relation to the civil penalty provisions such as sec 601FC, sec 1317DB). This may

1. (1894) L R 9 Ch App 244.
2. See below.

be a significant source of liability for officers where the responsible entity itself has breached a provision of Chapter 5C.

The duties of officers and employees of the responsible entity, and of compliance committee members, are discussed below. The extent to which they may also be liable as 'accessories' (in the broad sense) to a breach by the responsible entity is also considered. This discussion is followed by an analysis of the consequences of a breach of duty. In addition, the responsible entity's ability to indemnify or insure its officers, employees and compliance committee members is addressed.

The duties of officers — introduction

Officers of responsible entities owe, in their capacity as such, duties to the responsible entity under general principles of company law. They are not, by virtue solely of holding that office, in a fiduciary relationship with scheme members. They are made subject to express statutory duties under sec 601FD.

Duties to the responsible entity

As an officer of the responsible entity, the person owes duties of loyalty, care and honesty to that company and can be liable to the company for breach of those duties. The responsible entity owes duties to the scheme members and "if directors pay insufficient attention to the interests of the beneficiaries, the result may be a claim against the company for breach of trust", resulting in a breach of "the general duty of directors [owed to the trustee company] not to incur claims against the company's estate by improper conduct".[3]

Note that the standard of care expected of a director of a trustee company may be, while the director is engaged in the business of the trust, higher than that owed in respect of the director's other activities. In *ASC* v *AS Nominees*, Finn J held that "at least when, and to the extent that, directors of a trustee company are themselves "concerned in" the breaches of trust of their company, they are liable to the company according to the same standard of care and caution as is expected of the company itself".[4] The precise nature and extent of that duty of care is discussed further below.

A claim against directors for a breach of duty owed to the trustee company is one that belongs to the company itself, and does not form part of the trust property in a strict sense. In *Young* v *Murphy,* a decision of the Full Court of the Supreme Court of Victoria arising out of the collapse of the Estate Mortgage trusts, Phillips J held, in the context of a claim by the new trustee for breach of duty by directors of the former trustee, that:

> any right of action against the . . . directors for breaches of duties said to have been owed to [the former trustee] remains with that company. The company is now in liquidation and so it is a matter for the liquidator whether to pursue the directors for those alleged breaches of duty. . . [T]he benefit of such proceedings would belong to the creditors generally, in the liquidation, consistently with

3. Ford, Austin and Ramsay [8.110].
4. (1995) 18 ACSR 459 at 470.

> my view that the directors owed their duties to [the trustee] and not to [the trustee] in a particular capacity.[5]

His Honour goes on to note that the beneficiaries will be concerned that the former trustee pursue its claim against the directors for breach of its duties, if the former trustee was called upon to recompense the beneficiaries for loss to the trust property. However the claim against the directors belongs to the trustee company, and not to the new trustee or the beneficiaries.

Scheme members cannot compel a responsible entity to bring an action for breach of duty owed by the directors to the responsible entity, nor is any compensation recovered by a responsible entity in these circumstances the property of the trust. The scheme members' rights are against the responsible entity itself as trustee.

No fiduciary relationship between the officers and the members

The rights of a beneficiary of a trust against directors of a corporate trustee are canvassed at length in the leading article on trading trusts by Ford and Hardingham, published in 1987.[303] It is generally accepted that a person in control of a fiduciary company does not owe to the beneficiary or principal the same duty as the corporate entity itself. The authors of *Ford's Principles of Corporations Law* conclude that, generally speaking, directors of a corporate trustee do not owe duties directly to the beneficiaries:

> To . . . say that a person in control of a fiduciary company owes to the beneficiary or principal the same duty as the corporate entity itself (*Savin & Boyle* v *De Vere* (1983) 1 BCR 545 at 549, *Hurley* v *BGH Nominees Pty Ltd (No 2)* (1984) 37 SASR 499 at 510; 10 ACLR 197 at 205; 2 ACLC 497 at 506 per Walters J; *Winkworth* v *Edward Baron Development Co Ltd* [1987] 1 All ER 114; *Inge* v *Inge* (1990) 3 ACSR 63) would only seem proper to the extent that it may be permissible to look through the corporate veil . . . The orthodox view that directors, as such, owe their duties to the corporate entity rather than the members (*Percival* v *Wright* [1920] 2 Ch 421) also suggests that there can be no duties to beneficiaries or principals: *Cope* v *Butcher* (1996) 20 ACSR 37.[7]

In *Hurley* v *BGH Nominees Pty Ltd* King CJ affirmed that "there is no authority which establishes that a director of a trustee company is under a fiduciary duty to the beneficiaries of the trust", and White J observed that "it will require a marked departure from current thinking and practice by the courts before a direct cause of action [between directors of the trustee and the beneficiaries] arises".[8]

In *ASC* v *AS Nominees,* Finn J considered whether the directors of two corporate trustees of various public offer superannuation trusts "owed fiduciary duties not just to their companies respectively, but also to the beneficiaries of the trusts of those companies". He held that:

> It is not open to doubt that the particular *factual* relationship existing between a (or the) director(s) of a trustee company and a beneficiary or beneficiaries of a trust, may properly warrant the finding

5. (1994) 13 ACSR 722, 748
6. Ford and Hardingham 58–68.
7. Ford, Austin and Ramsay [8.110].
8. (1982) 1 ACLC 387.

of fiduciary relationship between them: cf *Coleman* v *Myers* [1977] 2 NZLR 225; *Glandon Pty Ltd* v *Strata Consolidated Pty Ltd* (1993) 11 ACSR 543. But to say this is not to say that there is anything fiduciary in the trust company director-trust beneficiary relationship as such.[9]

Statutory duties of officers of responsible entity

The position at general law is displaced in part sec 601FD which prescribes the duties of officers of responsible entities. The duties are derived in part from the proposals made by ALRC/CASAC in its *Report No 65*. ALRC/CASAC had recommended that:

> investors should have obligations owed to them by the officers of the operator. Investors should be able to take action against officers to enforce these rights directly, without first proceeding against the company. The nature of the rights should be modeled on the Corporations Law sec 232. The precise form of the recommendations follows the provisions in the Corporations Law sec 232 so that officers will not face additional kinds of liability under the proposal.[10]

The duties owed by officers of responsible entities fall into two categories:

- fiduciary-type duties of honesty and loyalty, and
- general and specific obligations of care and diligence, incorporating an obligation to take all reasonable steps to ensure compliance by the responsible entity with its obligations.

The fiduciary-type obligations

The fiduciary-type obligations are clearly modeled on sec 232 of the Corporations Law, although they are not identical in their content. In their application, sec 232 and sec 601FD are likely to overlap to a considerable degree. An officer of a responsible entity is already required by sec 232 to act honestly and with care and diligence, and to avoid making improper use of information or position, although these are duties owed to the responsible entity as a company, and not to the scheme members. Although it is not explicit on the face of sec 601FD, it seems likely that courts will apply this section having regard to the special and distinct interests of scheme members, rather than of the responsible entity as a company.

Duty of honesty

Section 601FD(1)(a) requires an officer of the responsible entity to act honestly. Guidance on the meaning of that provision can be found in the case law on sec 232(2) of the Corporations Law. The section does not state whether this requirement should be viewed as one to exercise powers in the interests of the scheme members, or the responsible entity itself.

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9. (1995) 18 ACSR 459, 474-5 Federal Court of Australia, Finn J.
10. ALRC/CASAC *Report No 65*, para 10.16. The *Managed Investments Bill 1997* itself did not give scheme members a right to enforce the performance obligations imposed on officers directly, and the debate on the Bill in the Senate suggests that this was intentional: see below. However the inclusion of reg 5C.11.07 means that scheme members do have a direct right of action against officers for breach of the statutory duties, beyond the right to injunctive relief in sec 1324.

However sec 601FD(1)(c) suggests that the requirement should be viewed as one to act in the interests of scheme members.

Duty to act in the interests of members

Section 601FD(1)(c) requires the officers of the responsible entity to prefer the interests of members of the scheme over the interests of the responsible entity in exercising their powers and performing their functions as officers.

Improper use of position and information

Section 601FD(1)(d) and (e) reflect in part sec 232(5) and (6) of the Corporations Law. Note however that, while sec 232(5) prohibits "improper use" to produce any advantage, sec 601FD(1)(d) prohibits any use to produce improper advantage.

Duty of care and diligence

Under sec 601FD(1)(b), the responsible entity's officers are subject to a statutory duty of care and diligence. In addition, under sec 601FD(1)(f) the officer must take "all steps that a reasonable person would take, if they were in the officer's position, to ensure that the responsible entity complies with" the Corporations Law, any conditions imposed on the dealers licence held by the responsible entity, the scheme's constitution and the compliance plan. This can be seen as either an extension or a reiteration of the duty of care contained in sec 601FD(1)(b).

The care and diligence obligations

Under sec 601FD(1)(b), a director of a responsible entity of a registered scheme must "exercise the degree of care and diligence that a reasonable person would exercise if they were in the officer's position". As officers of a company, they are already subject to a statutory duty to exercise, in the exercise of their powers and the discharge of their duties, the "degree of care and diligence that a reasonable person in a like position in the corporation would exercise in the corporation's circumstances".[11] As such, the duties under sec 601FD(1) and sec 232(4) probably overlap to a considerable extent, although note that some of the more subjective elements present in the formulation of the duty in sec 232(4) are absent from sec 601FC(1)(b).

Section 601FD(1)(b) requires the officer to exercise the degree of care and diligence that a reasonable person would exercise in the officer's position. In the case of a scheme that is structured as a trust, the officer's position is that of an officer of a corporate trustee. Accordingly their performance must be measured against that standard.

11. Section 232(4).

In *ASC* v *AS Nominees*, Finn J reviewed the standard of care to be expected of a director of the trustee of a publicly offered investment trust. He concluded that "at least when, and to the extent that, directors of a trustee company are themselves "concerned in" the breaches of trust of their company, they are liable to the company according to the same standard of care and caution as is expected of the company itself".[12]

Duty to take reasonable steps to ensure compliance

Section 601FD(1)(f) requires that officers of the responsible entity "take all steps that a reasonable person would take, if they were in the officer's position, to ensure" that the responsible entity complies with:

- the Corporations Law, and
- any conditions imposed on the responsible entity's dealers licence, and
- the scheme's constitution, and
- the scheme's compliance plan.

This section is based on the recommendation in para 10.22 of ALRC/CASAC *Report No 65*. It may overlap to a certain extent with the duty of care and diligence contained in sec 601FD(1)(b).

The requirement incorporates both objective (in the form of a "reasonable person" test) and subjective (through the requirement to have regard to the officer's position) elements. In the Explanatory Memorandum to the Corporate Law Reform Bill 1992 which introduced the present duty of care requirement for company directors, it was stated that "Australian law recognises that the special background, qualifications and management responsibilities of the particular officer may be relevant in evaluating his compliance with the standard of care".[13] Similarly, it is possible that the special background, qualifications and management responsibilities of the particular officer will be taken into account in determining what is reasonable for that officer to do to ensure compliance by the responsible entity with its obligations.

The fact that the special management responsibilities of the particular officer should be taken into account may have special significance for external directors. Chapter 6 above considers the question of whether external directors of a responsible entity that operates a scheme for which there is no compliance committee owe special duties to monitor compliance with the compliance plan, arising out of their special position on the board.

Duty overrides sec 232

The duty owed by the officer under sec 601FD(1) is expressed to override any conflicting duty the officer has under sec 232. In its *Report No 65* ALRC/CASAC recommended that "officers should be given statutory protection from claims by the operator or its share-

12. (1995) 18 ACSR 459 at 470.
13. Explanatory Memorandum to the Corporate Law Reform Bill 1992 para 85–6.

holders arising from any loss they suffered in consequence of the officers complying with their paramount duty to investors".[14] To the extent that the expression "overrides" is unclear, it may be that it is interpreted to give officers of the responsible entity a defence to any claim arising out of a breach of sec 232. What is not clear is whether the statutory protection extends to duties owed by the officer to the responsible entity otherwise than under sec 232, for example because of the fiduciary relationship between the officer and the responsible entity itself. However it is difficult to imagine that an officer, acting in a manner consistent with, or to comply with, a statutory obligation owed by the company, could be found to be in breach of duty to the company.

The duties of officers — conflicts of interest and dealings with scheme property

This part examines briefly the position of officers of a responsible entity dealing with the responsible entity in its capacity as such. There is no statutory restriction on officers of a responsible entity transacting with the scheme, beyond those contained in the related party provisions in Part 5C.7 and reg 5C.7.01. However general law restrictions may apply.

Situations in which the responsible entity, in its capacity as such, may be dealing with its officers or officer related entities include in relation to the issue or redemption of interests in the scheme, the sale or purchase of scheme assets, or contracting for the provision of services and so on.

Some important observations can be made about such dealings.

First, the ordinary rules that apply to transactions between public companies and their officers need to be taken into account. These include sec 232A and Chapter 2E.[15]

Secondly, Part 5C. 7 and reg 5C.7.01 are likely to apply, if under the terms of the transaction the responsible entity confers a financial benefit on a related party that comes out of scheme property. Directors, director controlled entities and certain relatives of directors are "related parties" of the responsible entity within the meaning of the legislation.

Part 5C.7 and reg 5C.7.01 are discussed in Chapter 5. The effect of reg 5C.7.01 may be to prohibit the responsible entity from conferring any financial benefit on a director that could diminish or endanger scheme property, even where the transaction is permitted under Part 2E.4 or 2E.5.

Thirdly, such a transaction may affect whether the director is an external director for the purposes of Part 5C.5. If the transaction results in the person being "substantially involved in business dealings, or in a professional capacity, with the responsible entity", that person cannot be considered an external director under sec 601JA(2).

Fourthly, the director may be prevented from transacting with the scheme under general law principles. In *ASC* v *AS Nominees* Finn J noted that:

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14. ALRC/CASAC *Report No 65* para 10.17.

15. Note that sec 232A(2) provides that subsection (1) does not apply to an interest that a director has as a member of the company and in common with the other members. However this does not exclude an interest that a director has as a member of the scheme in common with all other scheme members. Where the directors themselves hold interests in the scheme (directly or indirectly) the operation of sec 232A(1) must be addressed.

> It is . . . not open to doubt that some at least of the disabilities fiduciary law imposes on a fiduciary (including a trust company) are imposed as well on officers, employees and agents of that fiduciary. A simple example is the rule in *Ex parte James* (1803) 8 Ves 337; 32 ER 385 proscribing the purchase of trust property: see eg *Re James; Bagot's Executor and Trustee Co Ltd* v *McGregor* [1949] SASR 143.[16]

Transactions with officers of the responsible entity may infringe these restrictions if the restrictions are not appropriately modified or excluded in the scheme constitution.[17]

Duties of employees

Section 601FE imposes duties on employees of responsible entities not to:

- make use of information acquired through being an employee of the responsible entity to gain an improper advantage for themselves or another person, or to cause detriment to the members of the scheme, or
- make improper use of their position as an employee to gain, directly or indirectly, an advantage for themselves or for any other person or to cause detriment to the members of the scheme.

The elements of the duty reflect to some extent sec 232(5) and (6) of the Corporations Law, and it seems likely that they will be interpreted in a manner consistent with those sections.

Section 601FE is a civil penalty provision under sec 1317DA.

Duty overrides sec 232

As with sec 601FD(1), a duty of an employee owed under sec 601FE is expressed to override any conflicting duty that the employee has under sec 232. Of course, the employee will be subject to a conflicting duty only if he or she is an officer of the responsible entity within the meaning of sec 232(1). Presumably in this case sec 601FD and not sec 601FE would apply. The section is only expressed to override duties owed under sec 232 and not, for example, under the contract of employment.

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16. Ibid, 474–5.
17. See Chapter 5 above. For example, in practice, trust deeds frequently permit the sale of trust property to the trustee. See eg *Smith* v *Green* (1903) 22 NZLR 976; *Re Billington* [1949] QRS 102; *Re Hayes Will Trust* [1971] 1 WLR 758. Where such a transaction is expressly permitted, that permission would presumably flow through to the officers and agents of the trustee.

    Such transactions raise a neat point where the constitution does not make appropriate provision, as to the ability of the scheme members to ratify (or authorise in advance) a transaction that would otherwise be in breach of duty. Generally speaking, in the context of trusts, any ratification or exoneration would require the unanimous consent of all of the beneficiaries. But in the case of a registered scheme, a special majority of members can amend the scheme constitution. Perhaps, if the constitution could be amended in advance to authorise a particular transaction by special majority, that same transaction should be capable of ratification afterwards by special majority, overturning the general law requirement for unanimous consent.

Duties of compliance committee members

In exercising the functions prescribed for the compliance committee under sec 601JC and discussed in Chapter 6 above, compliance committee members are required to act honestly and with the degree of care and diligence that a reasonable person would exercise if they were in the member's position, and are prohibited from making improper use of their position or of information acquired through that position to the detriment of the members of the scheme or for their own or another person's improper advantage.[18] The content of the duties overlap with those prescribed for officers of the responsible entity, that are discussed above.

However the difference roles played, respectively, by the compliance committee members and the directors affects the nature of the duty of care owed by them. Unless compliance committee members put themselves in the position of controlling the responsible entity, it seems unlikely that they would be 'infected' with the special duty of care (mirroring that owed by the responsible entity itself to the scheme members) identified by Finn J in *ASC* v *AS Nominees* and discussed above. The standard of care against which their performance should be measured is that of a reasonable person in the member's position. Their position may be more akin to that of an auditor, than that of a director.

It is not clear whether the members' duties under sec 601JD are relevant only in relation to the discharge of their statutory function, or whether those duties themselves may be the source of more extensive obligations or a more expanded role, beyond the limited functions set out in sec 601JC. For example, does the members' duty of care of itself require them to undertake an investigation, or take action, beyond that required by sec 601JC on its terms? Arguably the better view is that sec 601JD does not have this effect, and the compliance committee is not required to do anything other than that expressly provided for in sec 601JC. In acting as members of that committee discharging its obligations under sec 601JC, and doing that which is necessary to enable the committee to function, the members are required to act in a manner consistent with sec 601JD.

Compliance committee members are required to disclose to the committee a "direct or indirect pecuniary interest that they have in a matter being considered, or about to be considered, by the committee if their interest could conflict with the proper performance of their duties in relation to the consideration of the matter".[19] The disclosure obligation appears more limited than that contained in either sec 231 or 232A of the Corporations Law, as it is limited to pecuniary interests and arises only where the interest "could conflict".

Compliance committee members are also under a duty to take all reasonable steps to assist ASIC in carrying out a check under sec 601FF(1). Committee members have qualified privilege in relation to any statements made to ASIC concerning operation of the scheme under sec 601JE.

Section 601FE(1) is a civil penalty provision under sec 1317DA. Accordingly, a committee member in breach of his or her duty under sec 601FE is exposed to the range

18. Section 601JD(1).

19. Section 601JJ.

of criminal and civil sanctions available under Part 9.4B of the Corporations Law. The responsible entity is given standing to seek under Division 5 of Part 9.4B to seek compensation, to form part of the scheme property, for a breach by a member of the duties set out in sec 601FE.

'Accessorial' liability

In addition to their potential liability for breach of duties imposed directly on them by sec 601FD, 601FE and sec 601JD, the officers and employees of a responsible entity and compliance committee members may be particularly vulnerable to liability for involvement in a contravention of the responsible entity's duties to scheme members. This liability may arise:

- under the principle know as the second limb of *Barnes* v *Addy*, or
- under sec 1317DB, sec 1324 or sec 1325.

Liability under the second limb of **Barnes v Addy**

Persons involved in a breach of duty by a trustee may be held personally liable to the beneficiaries under the principles established in *Barnes* v *Addy*.[20] If the person has:

- received or dealt with trust property knowing that the receipt or dealing was in breach of trust, or
- knowingly assisted or induced the trustee company in its dishonest and fraudulent design,

any trust property received will be impressed with a constructive trust, and, in the second case, the director will be personally liable for any losses, and held accountable for any gains, to the trust fund.

In *ASC* v *AS Nominees Ltd* Finn J expressed the view that the second limb of *Barnes* v *Addy* (sometimes referred to as the "knowing assistance" limb) is of special significance in the case of directors of a fiduciary company. He characterised the rule:

> (conservatively) as one which exposes a third party to the full range of equitable remedy against a trustee if the person knowingly or recklessly assists in or procures a breach of trust or of fiduciary duty by a trustee: *Consul Development Pty Ltd* v *DPC Estates Pty Ltd* (1975) 132 CLR 373; 5 ALR 231; see *Royal Brunei Airlines Sdn Bhd* v *Tan* [1995] 3 WLR 64 and the cases and writings referred to therein . . .
>
> [T]his form of liability is one of no little significance to the directors of a trust company for the very reason that, often enough, it will be their own conduct in exercising the powers of the board which causes the company to commit a breach of trust. They are, in other words, peculiarly vulnerable to this rule. Recent Australian case law is demonstrating an application of this: see eg *Young* v *Murphy* (1994) 13 ACSR 722; see also *Biala Pty Ltd* v *Mallina Holdings Ltd* (1993) 11 ACSR 785 at 832.[21]

20. (1894) L R 9 Ch App 244.
21. (1995) 18 ACSR 459 at 475–6.

Liability under the second limb of *Barnes* v *Addy* requires that their be "a dishonest or fraudulent design" on the part of the trustee, of which the director had the requisite degree of knowledge and which the director assisted or induced. A breach of fiduciary duty on the part of the trustee may be sufficient to constitute a "dishonest or fraudulent design" for this purpose.[22] There is some controversy of the nature of the knowledge requirement in this context,[23] although that may have been put to rest to some degree by the judgment of Hansen J in the recent *Farrow Finance Co Ltd (in liq)* v *Farrow Properties Pty Ltd (in liq)*.[24] In that case His Honour expressed the view that:

> The standard of fault required of a person against whom a claim is brought under the . . . accessory liability . . . limb of *Barnes* v *Addy* is, in my view, now beyond doubt. In the advice of the Privy Council in *Royal Brunei Airlines Sdn Bhd* v *Tan* [1995] 2 AC 378 an essential ingredient of accessory liability under *Barnes* v *Addy* was said to be the establishment of the defendant's dishonesty. What must be considered is what the objective standard of honesty required the defendant to do in the circumstances with which he or she was faced.[25]

Accessorial liability under the statute

Under sec 1317DB, a person who is involved in a contravention of a civil penalty provision is taken to have contravened that provision. Therefore an officer or employee of a responsible entity, or a compliance committee member, who is involved in a contravention by the responsible entity of its duties under sec 601FC will be treated as primarily liable for breach of that section.

Similarly the Court can make orders under sec 1325 against any person who is involved in a contravention of Chapter 5C.[26]

"Involved in a contravention" is defined in sec 79. It provides that a person is involved in a contravention if, and only if, the person:

- has aided, abetted, counselled or procured the contravention
- has induced or attempted to induce, whether by threats, promises or otherwise, the contravention
- has been in any way, by act or omission, directly or indirectly, knowingly concerned in, or party to, the contravention, or
- conspired with others to effect the contravention.

Section 79 is based on sec 75B of the *Trade Practices Act 1973* (Cth), and the general accessorial liability provisions in sec 5 of the *Crimes Act 1914* (Cth). It is generally accepted that a person is involved in a contravention only if the person knows all the relevant facts that made up the contravention or deliberately shuts their eyes to the truth.[27] In

22. *Consul Developments Pty Ltd* v *DPC Estates Pty Ltd* (1975) 132 CLR 373 at 398 per Gibbs J.
23. See Lodge "Barnes v Addy: The Requirements of Knowledge" (1995) 23 *Australian Business Law Review* 25.
24. (1997) 26 ACSR 544.
25. Ibid, 544.
26. Section 1325 applies by operation of reg 5C.11.07.
27. *York* v *Lucas* (1985) 158 CLR 661; 61 ALR 301; *Edwards* v *R* (1992) 173 CLR 653; 107 ALR 190; 7 ACSR 500; 66 ALJR 394. It is not necessary to show that the person knew those facts amounted to an offence.

Giorgianni v *R* the High Court held that no person may be convicted of aiding, abetting, counselling or procuring the commission of an offence unless, knowing all the essential facts which made the act an offence, the person intentionally aided, abetted, counselled or procured the acts of the principal offender. Wilful blindness is equivalent to knowledge for this purpose, but negligence or recklessness is not sufficient.[28]

The person who was the 'directing mind and will' of the responsible entity in relation to the contravention may be treated as its accessory where the requisite degree of knowledge is present. For example, in *Hamilton* v *Whitehead* a proprietary company had contravened the provisions of the Companies (WA) Code by offering prescribed interests. The company's managing director was charged as an accessory knowingly concerned in the company's offence. The High Court of Australia rejected argument that it was wrong and oppressive to prosecute the managing director for the identical acts as were relied on as the acts of the company.[29]

Under sec 1324, the court may grant an injunction or order the payment of damages by a person who has engaged, is engaging or is proposing to engage in conduct that constituted, constitutes or would constitute, among other things:

- aiding, abetting, counselling or procuring a person to contravene the Law
- inducing or attempting to induce, whether by threats, promises or otherwise, a person to contravene the Law
- being in any way, directly or indirectly, knowingly concerned in, or party to, the contravention by a person of the Law, or
- conspiring with others to contravene the Law.

Natural persons who are involved in the management of the scheme may be made the subject of orders under sec 1324 on this basis.

Consequences of a breach

Where a person has contravened sec 601FD, sec 601FE or sec 601JD, or has been involved in a contravention of a civil penalty provision and is therefore liable for that breach under sec 1317DB, the person may be subject to sanctions and civil liability under Part 9.4B, and to civil liability under sec 1324 and 1325. In addition, if the person is liable under the second limb of *Barnes* v *Addy*, they may be exposed to equitable remedies with respect to that liability.

The remedies are discussed in greater detail in Chapters 8 and 10 below.

Part 9.4B

Sections 601FD(1), 601FE(1) and 601JD(1) are civil penalty provisions.[30] Accordingly Part 9.4B sets out (some of) the consequences of breaching those provisions.

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28. (1985) 156 CLR 473.
29. (1988) 166 CLR 121.
30. Section 1317DA.

In addition, a person who is involved in a contravention of another of the civil penalty provision (for example, of the statutory duties owed by the responsible entity to scheme members under sec 601FC) is taken to have contravened that provision for the purposes of Part 9.4B.[31] Sections 601FC(1)[32] and 601FG(1)[33] are civil penalty provisions and involvement in a contravention by the responsible entity of those sections will also attract the operation of Part 9.4B.

Where a breach of a civil penalty provision has occurred, a civil penalty order may be made against the wrongdoer or, where the requisite degree of scienter is present, the person may be convicted of a criminal offence.[34] Orders that the person compensate the scheme may be made in connection with the civil penalty or criminal proceedings.[35] In addition, the person is liable to account to the scheme for any profit made, or an amount equal to any loss or damage sustained by the scheme, as a result of the contravention. The amount may be recovered by the responsible entity on behalf of the scheme as a debt.[36] The Court has power to relieve the person from civil liability under sec 1317JA.

Civil liability under sec 1325

Regulation 5C.11.07 provides that "a reference in sec 1325 to Part 7.12 of the Corporations Law is taken to include a reference to Chapter 5C of the Law". Under sec 1325(2)

> The Court may, on the application of a person who has suffered, or is likely to suffer, loss or damage because of conduct of another person that was engaged in in contravention of [Chapter 5C], or on the application of the Commission in accordance with subsection (3) on behalf of such a person or 2 or more such persons, make such order or orders as the Court thinks appropriate against the person who engaged in the conduct or a person who was involved in the contravention (including all or any of the orders mentioned in subparagraph (5) if the Court considers that the order or orders concerned will compensate the person . . . in whole or in part for the loss or damage, or will prevent or reduce the loss or damage suffered, or likely to be suffered, by such a person.

Section 1325 reflects the language in sec 1005 which in turn is based on the former sec 107 of the Companies Codes and sec 82 and 85 of the *Trade Practices Act 1974* (Cth).

Therefore the effect of reg 5C.11.07 is to give scheme members a statutory basis on which officers, employees and compliance committee members can be held directly accountable for breach of their statutory duties. As such, the regulation appears to be directly contrary to Parliamentary intention.

The intention underlying Chapter 5C appears to have been that the scheme members should be given a single person, wholly responsible for the conduct of the scheme, to whom they could look for recourse. The Explanatory Memorandum to sec 601MA states that:

31. Section 1317DB.
32. Setting out the duties of a responsible entity.
33. Prohibiting acquisition by the responsible entity of interests in the scheme otherwise than on the same terms as other members.
34. A person is guilty of an offence if they breach a civil penalty provision knowingly, intentionally or recklessly, and with an intention to deceive or defraud, or dishonestly and intending to gain.
35. Section 1317HA and 1317HB.
36. Section 1317HD.

> The right to bring a statutory action will not extend to actions against other persons involved in the operation of the scheme (such as directors, compliance committee members or any entity engaged by the responsible entity to have custody of the scheme property). A member's right to bring an action against these persons will depend on the general law and will not be set out in the Law. This will preserve the concept of a single responsible entity responsible to members for the operation of the scheme.[37]

In the long debate on the bill in the Senate in June 1998, Senator Margetts of the WA Greens moved an amendment to the proposed sec 601MA to give scheme members a direct statutory right of action against the responsible entity or a director, secretary or executive officer of the responsible entity for breach by any of them of a provision of Chapter 5C, including sec 601FD.[38] The amendment was opposed by both the Government and the Opposition.

In moving her amendments Senator Margetts argued that imposing liability on officers of the responsible entity restored protection afforded under Part 7.12, was consistent with the position of directors of trustees of public offer superannuation funds, and overcame the limitations of relying on the ASIC or the responsible entity (which may be under the control of the wrongdoing directors) to enforce compliance by the directors with their obligations under sec 601FD.[39]

Senator Campbell, Parliamentary Secretary to the Treasurer, did not support the amendment, arguing that "by making other entities responsible in this way you diminish the responsibility of the responsible entity by definition .... In so doing it will specifically and quite clearly reduce the responsibility of the responsible entity to the investors . . . [B]y creating a distinct and different line of responsibility to these officers and investors, you are undermining, diminishing and attacking the core investor protection provision and foundations of the single responsible entity scheme".[40]

Senator Cook, Deputy Leader of the Opposition in the Senate, also opposed the amendments, arguing that "the purpose of this bill is to put the key weight of responsibility on the so-called single responsible entity. That is why the entity is so named, and that is the purpose of this whole piece of legislation — to make that the decisive element in governing managed investment schemes. Reading this amendment, I do think it does water down that objective."[41]

It appears from the debate that Senators Campbell and Cook both took the view that the imposition of direct statutory liability on officers of the responsible entity under sec 601MA would undermine the legislative intention of the regulatory scheme. It is clear that both the Government and the Opposition rejected an amendment to the principal legislation to create direct liability. However the effect of reg 5C.11.07 is just that.

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37. Explanatory Memorandum para 14.2.
38. Greens amendments 25–28: see Commonwealth, *Parliamentary Debates*, Senate, 23 June 1998, 3427 (Senator Margetts).
39. Ibid 3427–8.
40. Ibid 3428–9 (Senator Campbell).
41. Ibid 3429–30 (Senator Cook).

Relief from liability

A court has power, in any civil proceedings against a person to whom the section applies for negligence, default, breach of trust or breach of duty in a capacity as such a person, to grant relief from liability where the person has acted honestly and, having regard to all the circumstances of the case, the person ought fairly to be excused.[42] The section applies only (relevantly) to "officers" and does not extend to employees or compliance committee members.

Application of sec 1324

Breach of the provisions of the Corporations Law that apply, respectively, to officers and employees of responsible entities and compliance committee members can be restrained by injunction under sec 1324. In addition, orders for damages may be available under sec 1324(10).

Statutory limitations on indemnity and insurance

The Corporations Law restricts the ability of a company to indemnify its officers, or exempt them from liability, except in certain limited circumstances. That restriction is contained in sec 241. Section 601JF restricts the ability of a responsible entity to indemnify compliance committee members. The payment of insurance premiums for officers by companies, and for compliance committee members by responsible entities, is regulated under sec 241A and 601JG respectively.

Indemnification of officers

Under sec 241 a company or related body corporate must not:

- indemnify a present or former officer against liability incurred by the person as officer or auditor, or
- exempt a person from such liability,

except in certain circumstances. The circumstances in which it is permitted to do so relate to third party liability and legal expenses.

Liability to third parties

Section 241 does not prevent the company from indemnifying its officers with respect to liabilities incurred to third parties, unless the liability arose out of conduct involving a lack of good faith. This is permitted under sec 241(2). In the present case, this would suggest that the company could indemnify its officers with respect to any liability they may have, arising

42. Sections 1317JA and 1318.

out of conduct not involving a lack of good faith, to scheme members and others under sec 1325, or to a responsible entity of a scheme where the responsible entity is not the company itself or a related body corporate.

Consider for example AB, who is a director of X Ltd. X Ltd is the responsible entity of a registered scheme. AB breaches her duty under sec 601FD. The breach did not involve a lack of good faith. After the breach has occurred but before proceedings are commenced, X Ltd resigns as responsible entity and is replaced by Y Ltd.

In this example, it appears that X Ltd could indemnify AB in respect of the breach whether the proceedings are commenced by Y Ltd as responsible entity or some other person with standing under sec 1324 or 1325 as the case may be.

However if X Ltd had remained as responsible entity, and AB was ordered to compensate X Ltd in its capacity as responsible entity for the scheme, X Ltd may be unable to indemnify AB with respect to the liability.

Indemnity for legal costs

The company may indemnify the officer against liability in successfully defending civil or criminal proceedings in which judgment is given in favour of the officer or in which he or she is acquitted.

Payment of officers' insurance premiums

A company may not pay a premium in respect of a contract insuring a person who is or has been an officer against a liability incurred by the person as an officer and arising out of conduct involving a wilful breach of duty in relation to the company, or a contravention of sec 232(5) or (6).

If a breach of sec 601FD is not a breach of duty *in relation to* the company, the company can arrange and pay for insurance with respect to liability under sec 601FC. The company can also insure the officer against the costs of defending proceedings for breach of sec 601FD, whether civil or criminal and whatever the outcome.[43]

Indemnification of compliance committee members

Sections 601JF and 601JG correspond loosely to sec 241 and 241A of the Corporations, which limit the extent to which a company can indemnify its officers or auditors and restrict payment of insurance premiums to certain types of cover.

Both sec 601JF and 601JG restrict the ability of the *responsible entity* and its related bodies corporate to give indemnities or provide insurance. As such they can be seen to protect the shareholders of the responsible entity, rather than the members of a scheme. It may

43. Section 241A(3). Officers' insurance is required, where it is reasonably available, by ASIC under the terms of Policy Statement 131.18.

be that there is no statutory restriction on structuring a constitution to require, say, that scheme members indemnify compliance committee members.

The effect of sec 601JF is that the responsible entity:

- cannot indemnify a compliance committee member for any liability of the compliance committee member to the responsible entity itself or to its related bodies corporate
- may indemnify or exempt from liability a compliance committee member for a liability to any other person, including a scheme member, provided the liability did not arising out of conduct involving a lack of good faith
- may indemnify the compliance committee members with respect to costs and expenses incurred in defending civil or criminal proceedings in which they are successful.

A provision in a scheme constitution that purports to do otherwise is void.

The responsible entity will be entitled to recover the amount of any indemnity provided from the scheme property only if its right to do so is specified in the constitution in accordance with sec 601GA(2).

Note that, under sec 1317HB(3), it appears that an order that a compliance committee member compensate the scheme for loss or damage resulting from a breach of sec 601JC is a liability "to the responsible entity", and therefore one in respect of which the compliance committee member cannot be indemnified even where the conduct did not involve a lack of good faith.

Section 601JF would not appear to prevent the responsible entity from indemnifying a compliance committee member against liability to a scheme member (say as a result of an order under sec 1324(10)), provided there was no lack of good faith. The effect of this is somewhat anomalous. If the claim is brought by a member, the committee member can be indemnified, but if the claim is brought by the responsible entity as trustee for the member, the person cannot.

Also, the effect of sec 601JF is unclear where there is a change of responsible entity. The prohibition in sec 601JF applies to a "scheme's responsible entity or a related body corporate". Presumably when the responsible entity changes, the former responsible entity is no longer bound by the prohibition. Note that the operation of sec 601JF is directly opposite to sec 241 where there is a change of responsible entity. Under sec 601JF, the former responsible entity is no longer bound by the section in respect of claims brought by the new responsible entity. Under sec 241, the former responsible entity remains subject to the section, but the claims brought by the new responsible entity will not result in a liability to the company itself.

The effect of sec 601JG is that the responsible entity can pay insurance premiums only for policies insuring against the costs of legal proceedings (whether successful or not) and against liability not arising out of a "wilful breach of a duty referred to in sec 601JD". The responsible entity will be able to recover the permitted premiums from scheme property only if its right to be so reimbursed is set out in the constitution in accordance with sec 601GA(2).

Chapter 8

Rights of Members

The Corporations Law confers certain rights on members of a managed investment scheme, including voting rights and rights to enforce the obligations owed to them through the courts. Those statutory rights supplement the members' general law rights arising out of its relationship with the responsible entity and (perhaps) the other members of the scheme.[1] In particular, the member may have contractual rights (arising out of the contract for subscription for interests) and rights as a beneficiary of a trust. The nature of the members' interest in a managed investment scheme has been the subject of extensive doctrinal analysis and is a matter of some complexity.[2] That complexity is exacerbated in the statutory context by the definition of 'member' contained in sec 9 of the Corporations Law, and discussed below.

This chapter collects together the principal statutory rights of members of a managed investment scheme. In particular, it examines members' voting rights (and the procedure for exercising those rights), their 'right' to withdraw from the scheme, their right to receive information, and their enforcement rights. It does not address members' rights on a change of control of the scheme, which are the subject of current reform proposals.[3]

While the discussion focuses on the statutory rights conferred on members, it is important to understand that additional rights conferred under the constitution, and rights existing at general law, may also be relevant. In addition, one author has recognised a significant cross-pollination from company law to the law of public unit trusts, based on their common antecedents in the deed of settlement company. It has been noted that, in the Australian cases over the last decade dealing with issues such as the majority unitholders' power to bind minority unitholders and the right of the trustee to disregard as requisition for a meeting, "courts utilized principles developed in company law cases. Their direct application to the unit trust context was justified on the ground that both the unit trust and the registered

1. The question of whether scheme members can be said to be in a relationship with each other is canvassed in Kam Fan Sin "Enforcing the Unit Trust Deed Amongst Unitholders" (1997) 15 *Company and Securities Law Journal* 108.
2. See, among others, Kam Fan Sin; Robert Hughes *The Law of Public Unit Trusts* (1992). The nature of the scheme members' interest in scheme property is discussed in Kriewaldt and Hemmings "A Unitholder's Interest (and Relevant Interest) in Trust Property" (1994) 12 *Company and Securities Law Journal* 451.
3. The Corporate Law Economic Reform Program has proposed to apply the takeover rules to listed managed investment schemes. Draft legislation to this effect is contained in the Corporate Law Economic Reform Bill 1998. Paragraphs 7.46–7.60 of the Explanatory Memorandum to that bill summarise the proposed provisions. On takeovers of managed investment schemes under the old regime, see David Brewster "Fiduciary Obligations of Trust Manager and the Takeover of Unit Trusts" (1990) *Company and Securities Law Journal* 303; Atanaskovic and Magarey "Takeovers of Unit Trusts: A Brief Review" (1987) 5 *Company and Securities Law Journal* 249; J W A Higgins "Takeovers of Unit Trusts" (1988) *Company and Securities Law Journal* 302; Green and Dhar "Takeovers of Public Unit Trusts" (1991) *Australian Business Law Review* 19.

company are siblings with a common parent, the deed of settlement company. Thus, instead of trust principles providing solutions to company problems, company law now provides answers to the trust when it is used as a means of collective investment. There has been a reverse cultivation of principles."[4] The extent to which the position of members is equated to that of shareholders in a company may come to expand the range of rights available under the general law to those members.

The definition of "member"

A member of a managed investment scheme is "a person who holds an interest in the scheme". "Interest" in a managed investment scheme means "a right to benefits produced by the scheme (whether the right is actual, prospective or contingent and whether it is enforceable or not)".[5] Regrettably the question of whether a person is a member of a scheme does not depend on whether the person appears in the register of members.[6] The breadth of the definition of "interest" may mean, for example, that a person who holds an option to acquire a unit in a unit trust is a "member" for this purpose, as they have a prospective or contingent right to benefits produced by the scheme. Where the person named in the register of members is itself a trustee, beneficiaries of that trust would also appear to be "members" on this test, and so on.

The breadth of the definition may create problems for the responsible entity in discharging its administrative functions, such as maintaining the register of members and providing annual reports to members.[7] It may also expand the categories of persons who are "members" for the purposes of calculating voting thresholds, determining entitlement to remedies under sec 601MA, and so on. To the extent that the responsible entity cannot know the identity of all those who may have a prospective or contingent interest, whether enforceable or not, in benefits produced by the scheme, it may be difficult as a practical matter to determine the extent and identity of the membership.

Voting rights

Chapter 5C confers on scheme members the right to vote on questions relating to whether:

- to amend the scheme constitution, unless the responsible entity reasonably considers the proposed change will not adversely affect members' rights
- to remove the responsible entity
- to approve the appointment of a new responsible entity
- to veto certain related party transactions, and
- to wind up the scheme.

4. Kam Fan Sin 45–6.
5. Section 9.
6. C.f. sec 246A.
7. See Chapter 4 above.

Scheme members do not have a general right to give the responsible entity directions as to the management of the scheme.[8] Unless further voting rights are conferred by the scheme constitution or under the general law applicable to the scheme,[9] it seems that members will not have power to pass resolutions on other matters.[10]

In exercising their voting rights, members of a registered scheme will be subject to the same restrictions as those that apply to shareholders in a company.[11] In particular the equitable doctrine of fraud on a power will no doubt have application in this context. The duties of majority unit holders in prescribed interest schemes under the previous law have been discussed elsewhere,[12] and the principles articulated continue to apply under the new law. Majority shareholders' duty not to abuse their voting powers, or to exercise them for a purpose which is foreign to the purpose for which they were given, would appear to govern as well the exercise of voting rights by members of a registered scheme. Robert Hughes argues:

> The extension of these duties to unit holders holding a controlling interest in the trust would appear to be supported by the comments of Dixon J in *Peters' American Delicacy Co* v *Heath*[13] . . . which suggested that the power to amend company articles had its genesis in deed of settlement trusts. As the exercise of this power by shareholders provides one of the more the prominent cases where the duty has been found to be breached, such a view could be supported more strongly by the approaches taken by Kennedy J in *Perpetual Trusts* v *Corporate West Management* [1989] WAR 117 and by Gummow J in *Elders Trustees* v *Reeves* [1987] 78 ALR 193 which would support the extension by analogy of company law principles to the case of a public unit trust.[14]

It would appear therefore that the reasoning of the High Court of Australia in *Gambotto* v *WCP Ltd*[15] may apply in this context.

Amending the constitution

The process for amending the constitution is discussed in Chapter 4 above. Member approval is required to modify, repeal or replace the constitution unless the responsible entity reasonably considers the change will not adversely affect members' rights.[16] The change requires a special resolution of members of the scheme.

8. C.f. the former sec 1069(1)(m). See ALRC/CASAC *Report No 65* para 11.18–11.19.
9. For example, if the scheme is a trust, members may have a right to extinguish the trust under the rule in *Saunders* v *Vautier* (1841) Cr & Ph 240; 49 ER 282.
10. See Chapter 5 above, on the division of power between the responsible entity and the scheme members, and *Smith* v *Permanent Trustee Australia Ltd* (1992) 10 ACLC 906, discussed below in relation to the members' power to requisition a meeting.
11. See Kam Fan Sin 45–6.
12. Ibid, and Robert Hughes *The Law of Public Unit Trusts* (1993) 234–6.
13. 1939) 61 CLR 457.
14. Robert Hughes, above n 12, 237. The view is given further weight by the decision in *Gra-ham Australia Pty Ltd* v *Perpetual Trustees WA Ltd* (1989) 1 WAR 65.
15. (1995) 13 ACLC 342.
16. Section 601GC.

Chapter 4 also considers the question of whether the scheme members can initiate constitutional amendment, or only veto amendments proposed by the responsible entity. As a general proposition, trust law does not authorise beneficiaries to force upon trustees modifications of the trust that imposes new duties or abrogate discretions or powers already held, or to direct the exercise of such discretions or powers.[17] ALRC/CASAC recommended that members be given the power to initiate constitutional amendments, subject to approval of the proposed amendment by the operator.[18] Absent such a provision in Chapter 5C, it may be that members do not have the power to initiate constitutional amendments.

In *Gra-ham Australia Pty Ltd* v *Perpetual Trustees WA Ltd* the court held that the power of a majority of members in a public unit trust to amend the trust deed extended to enable amendments that would defeat vested or accrued rights of a member.[19]

Removing the responsible entity

Members can resolve by extraordinary resolution to remove the responsible entity.[20] The procedure for removing the responsible entity is discussed in Chapter 4 above. Such a power is said by ARLC/CASAC to reflect "the ultimate expression of dissatisfaction by investors in a collective investment scheme".[21]

As an alternative to removal by resolution of the members, a single member may make application to the Court for removal of the responsible entity under sec 601FN or reg 5C.2.02. This procedure is discussed below.

Approving a new responsible entity

If the scheme is to continue as a registered scheme, appointment of a new responsible entity will be required following the appointment of a temporary responsible entity by the Court, on resignation of the responsible entity, or on removal of the responsible entity by the members.

A new responsible entity can be appointed only with the approval of the members. An extraordinary resolution is required. The approval requirements, and the necessary procedures, are set out in Division 2 of Part 5C.2, and discussed in Chapter 4 above.

Approving related party transactions

Part 5C. 7 purports to apply Chapter 2E to financial benefits conferred by the responsible entity and its related parties that diminish or endanger scheme property, or could adversely affect the interests of members of the scheme. The object of the legislation, expressed in

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17. *Jacob's Law of Trusts* [2313].
18. ALRC/CASAC *Report No 65* para 11.22.
19. (1989) 1 WAR 65, 84.
20. Section 601FM.
21. ALRC/CASAC *Report No 65* para 11.17.

sec 243A as modified by sec 601LB, is that any such benefit "be disclosed, and approved by a members' meeting" before it is given. The related party transaction provisions are discussed at length in Chapter 5 above.

This suggests that members have the right to veto certain self-dealing and related party transactions by the responsible entity involving scheme property. This certainly appears to be the legislative intent underlying Part 5C.7.[22] However the operation of Part 5C.7 and reg 5C.7.01 is complex[23] and it is not clear what the significance of approval given under Part 2E.5 is for purposes other than sec 243H. In particular, member approval for a transaction given under Part 2E.5 would appear not to ratify or excuse a breach of sec 601FC.

Regulation 5C.7.01(3) would appear to forbid any financial benefit being conferred by the responsible entity, its agents or its controlled entities, or themselves or their respective related parties out of scheme property that could diminish or endanger the property or adversely affect the interests of members. Fees and indemnities provided for in the constitution are excluded,[24] however benefits conferred with member approval under Part 2E.5 are not excluded from this prohibition.

Certain other financial benefits are permitted only with member approval given under Part 2E.5.[25] Any benefit conferred by the responsible entity, its agents or its controlled entities, on themselves or their respective related parties out of scheme property that is not expressly prohibited by reg 5C.7.01(3) may proceed, but only in accordance with Part 2E.4 or 2E.5.[26] Similarly, a financial benefit given out of scheme property by a child entity of the responsible entity to the responsible entity is prohibited unless Part 2E.4 or 2E.5 permits it to be given.[27]

If member approval is sought in accordance with Part 2E.5, it should be noted that special notice and voting procedures apply. Part 2E.5 applies as modified by sec 601LA. The conditions to be satisfied are set out in Division 2 of Part 2E.5, and include preparation of an explanatory statement and lodgment of the proposed notice of meeting with ASIC.

Voting restrictions apply under sec 243ZF. Note that the restrictions apply only to a "related party" of the responsible entity receiving the benefit, and its associates. Where the person receiving the benefit is not a related party of the responsible entity, but approval is required under reg 5C.7.01, there appears to be no restriction on voting by the person receiving the benefit.

Members' meetings

Special provisions govern meetings held for the purposes of Part 2E.5. Other members' meetings are governed by Part 2G.4 of the Corporations Law. The requirements and

22. Explanatory Memorandum para 13.1–13.5 and ARLC/CASAC *Report No 65* para 10.24–10.26.
23. There are a number of significant defects in the purported application of related party transaction provision to managed investment schemes. Given the very obvious shortcomings of the legislation, it may be that urgent amendment is required.
24. Regulation 5C.7.01(4).
25. Section 243H as modified by sec 601LC and reg 5C.7.01(2).
26. That is, if it comes within one of the statutory exceptions to the prohibition or is approved by members.
27. Section 243H(2)(a) as modified by sec 601LC.

procedures for members' meetings generally have been harmonised to a degree with the new rules governing meetings of members of companies, contained in Part 2G.2.

Convening meetings

Division 1 of Part 2G.4 deals with who can convene a members' meeting. Under sec 252A, the responsible entity may call a meeting of members.

The scheme members may requisition a meeting to consider a special or extraordinary resolution, under the procedure set out in sec 252B. The responsible entity must call a meeting within the prescribed time when requested to do so by members with at least 5% of the votes that may be cast on the proposed resolution or at least 100 members entitled to vote on it.[28] The requisition must relate to a matter competent the general meeting of members, therefore the responsible entity is not required to accede to the request if the proposed resolutions relate to something "illegal or completely fatuous".[29] The notice of meeting must be sent within 21 days after the request is received by the responsible entity in writing, and the meeting must be held within two months from that date.

Costs for a requisitioned meeting can be recovered from scheme property.[30] This appears to be an exception to the general rule that the responsible entity is not entitled to be indemnified for any costs incurred except those expressly provided for in the constitution.[31]

If the responsible entity fails to call the meeting within the required time, members with more than 50% of the votes carried by the original requisitioners can call and arrange the meeting. Costs are borne by the responsible entity, which is not entitled to recover them from scheme property.[32]

Members themselves may call a meeting without requisitioning the responsible entity to do so, under sec 252D, to consider special or extraordinary resolutions. The members calling the meeting must hold between them at least 5% of the votes to be cast. If this procedure is used, the costs are borne by the members themselves. The procedure may be useful where the members are anxious to avoid undue delay. Members calling the meeting themselves will get their meeting 21 days from the date of the notice. If they requisition the responsible entity to convene a meeting, they may have to wait up to two months from the date of the requisition.

The court has a residual power to call a meeting where it is impracticable to call a meeting any other way, on application of the responsible entity or any member.[33] The Court's statutory power to do so is much narrower than its inherent jurisdiction at general law to control the administration of trusts.

Division 2 of Part 2G.4 governs notice. Section 252F requires at least 21 days notice of meeting, or any longer period specified in the constitution. Notice must be given to each

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28. Section 252B.
29. *Smith* v *Permanent Trustee Australia Ltd* (1992) 10 ACLC 906, 916 per Young J.
30. Section 252B(9).
31. Section 601GA.
32. Section 252C.
33. Section 252E.

member entitled to vote, each director of the responsible entity, and the auditors of the scheme and the compliance plan.[34] The contents of the notice of meeting are prescribed by sec 252J, which is based on sec 249L.

Division 3 provides for members to propose resolutions for consideration at a members' meetings. Given that annual general meetings of schemes are not required under the statute, the procedure in Division 3 may be used less frequently than that in Division 1 (where the members also instigate the meeting). Members holding at least 5% of the votes, or numbering at least 100, may request that a special or extraordinary resolution be included for consideration at a members' meeting.[35] The way in which the responsible entity is to deal with such a request is dealt with in Division 3 of Part 2G.4.

Voting at and conduct of meetings

Division 4 of Part 2G.4 deals with holding the meeting. The quorum provisions are set out in sec 252R, subject to provisions to the contrary in the scheme constitution. The appointment of proxies and representatives of members who are bodies corporate is governed by Division 5. Members of registered schemes always have the right to appoint a proxy and that the notice of meeting must state that right and that the proxy need not be a member of the scheme.[36]

Member voting is governed by Division 6. On a show of hands, each member has one vote.[37] The constitution may provide that a proxy does not have a vote on a show of hands.[38] Section 253C(2) provides that, on a poll, each member of the scheme has "1 vote for each dollar of the value of the total interests they have in the scheme". Presumably this section means that, for example, a member with interests in the scheme valued at $200,000 would have 200,000 votes on a poll. The basis on which that value is to be calculated is set out in sec 253F. Listed interests are valued at their market price, unlisted interests in liquid schemes that allow for withdrawal at their exit price, and unlisted schemes that are not liquid, or that do not allow for withdrawal, by the responsible entity.

All special resolutions and extraordinary resolutions must be decided on a poll.[39] Other resolutions may be decided on a show of hands except where a poll is effectively demanded under sec 253L.

Section 253E provides that "the responsible entity of a registered scheme and its associates are not entitled to vote their interest on a resolution at a meeting of the scheme's members if they have an interest in the resolution or matter other than as a member. This reflects, in part, the restrictions on voting in the former reg 7.12.15(3), (6)(f), and (9), but is narrower than ALRC/CASAC's recommendation that interests held by the scheme

34. Section 252G.
35. Section 252L.
36. Section 252J.
37. Section 253C. As all special resolutions and extraordinary resolutions must be decided on a poll, voting by show of hands in a registered scheme is rare.
38. Section 252W(2).
39. Section 253J.

operator or its associates should be non-voting except where they are held on bare trust and the operator or associate has no say in determining how to vote the interests.[40]

The statutory restrictions on variation of the class rights of members of companies, contained in sec 246B, do not apply in the context of registered scheme. ASIC has, by class order, modified the operation of the Corporations Law to allow class rights to be entrenched in the constitution, but unless the necessary provisions have been included the separate consent of members differentially affected by different resolutions may not be required.

Nevertheless it seems likely that the power of majority interest holders to exercise their voting rights to the detriment of the minority is limited by the general law, in particular the equitable doctrine of fraud on a power.[41]

Minutes of meeting

Minutes of members' meetings must be kept by the responsible entity under Division 7 of Part 2G.4, and made available for inspection in the manner prescribed.

Withdrawal rights

It is somewhat misleading to refer to a member's right to withdraw from a registered scheme. Such a right will exist only if it is provided for in the constitution. Its extent and operation, including the circumstances in which it can be suspended, will depend entirely upon the terms of the constitution. This reverses the position under the previous law.

Under the former Division 5 of Part 7.12 of the Corporations Law, approved deeds for prescribed interest schemes were required to include a buy-back covenant, defined in sec 9 as "a covenant binding the management company that it will, if asked by the holder of a prescribed interest to which the deed relates, buy the prescribed interest, or cause it to be bought, from the holder at a price calculated in accordance with the deed". In practice, this requirement was often discharged through the redemption of interests, under which a portion of the scheme assets representing the scheme member's relative share, less transaction costs, was returned to the scheme member by the trustee in return for cancellation of the interest.

The ASC granted relief from the buy-back covenant in certain circumstances (including for listed trusts and fixed term property syndicates) and its operation was modified in

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40. ALRC/CASAC *Report No 65* para 11.26.

41. See *Gra-ham Australia Pty Ltd* v *Perpetual Trustees WA Ltd* (1989) 1 WAR 65; Robert Hughes *The Law of Public Unit Trusts*, 237; Guy Spalvold "The Unit Trust—A Comparison with the Corporation" (1991) 3 *Bond Law Review* 249, 258. The concept of majority rule is of course foreign to the general law of trusts, where each beneficiary is in a relationship with the trustee and not with other beneficiaries, and the actions of one beneficiary cannot affect the interests of another without his or her consent. Yet majority rule is clearly provided for, and effective, in the context of the registered scheme in relation to various matters affecting the scheme. Corporate law principles are adapted to protect the interests of members in these circumstances.

relation to unlisted property trusts by the introduction in 1990 of the former Division 5A of Part 7.12.

Chapter 5C does not include a mandatory buy-back or redemption obligation. Instead, the responsible entity of a registered scheme may elect to provide for withdrawal in its constitution. Where a constitution does provide for withdrawal, that facility must be offered on the basis set out in the constitution. If the scheme is not liquid, further restrictions that prevail over the constitution apply to that process.

The provisions governing withdrawal are set out in Part 5C.6. Withdrawal is not permitted except in accordance with the Part.[42]

Removing compulsory buy-back reflects the recommendation of ALRC/CASAC in *Report No 65*, that there be no statutory obligation on scheme operators to offer redemptions. ALRC/CASAC concluded that market forces would operate to reduce the possibility that scheme operators would lock in investors by declining to make redemption offers.[43]

Part 5C.6 applies to "withdrawal". Withdrawal is not defined. Arguably a person withdraws from a scheme when they transfer their interest in the scheme to another person, either the responsible entity or a third party.[44] However the design of Part 5C.6 suggests that withdrawal in this context does not include transfer or distributions on a winding up. Instead the Part seems to be directed at withdrawal through the redemption of interests from scheme property. Interpreted otherwise, the Part would effectively prohibit (through sec 601KB to 601KE) the transfer of interests in non-liquid schemes, including listed property trusts.

Withdrawal from liquid schemes

Withdrawal from liquid schemes is permitted on the terms of the scheme's constitution.[45] The constitution must set out the arrangements for withdrawal.[46] The required contents, including the requirements relating to exit price, are discussed in Chapter 3 above. The responsible entity is prohibited from allowing withdrawal except in accordance with the constitution.[47]

As the members' withdrawal entitlements can be fixed by the responsible entity in the constitution, there appears to be nothing to prevent the responsible entity including in the

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42. Section 601KA(3). Presumably this would defeat the ability of members, as beneficiaries entitled to an aliquot share, to sever a share of scheme property under the principle articulated in *Re Sandeman's Will Trusts* [1937] 1 All ER 368.
43. ALRC/CASAC *Report No 65*, para 7.22.
44. ALRC/CASAC note that "there are four ways an investor may be able to withdraw his or her investment from a collective investment scheme:
    - redeeming his or her interests from the scheme
    - requiring the scheme operator to buy back his or her interests in the scheme
    - selling his or her interests on a recognised exchange or by private arrangement, or
    - terminating the scheme and liquidating its assets": ALRC/CASAC *Report No 65* para 7.2.
45. Section 601KA(1).
46. Section 601GA(4).
47. Section 601KA(3)(a).

constitutiona provision allowing it to suspend withdrawal in specified circumstances. However any such qualification to withdrawal rights would need to be disclosed in the prospectus under Division 2 of Part 7.12, and would be inoperative to the extent that it was inconsistent with the responsible entity's obligations under sec 601FC (including its duty to act impartially and in the best interest of members).

A scheme is "liquid" if liquid assets account for more than 80% of the value of scheme property.[48] Through the combined operation of sec 601KA(5) and (6), the question of whether an asset is liquid depends in large part on the period specified in the constitution for satisfying withdrawal requests. Property is liquid if the responsible entity reasonably expects that it can be realised for its market value within the period provided in the constitution for withdrawal requests to be satisfied. For example, if the constitution provides for withdrawal requests to be satisfied within seven days, any property that the responsible entity reasonably expects can be realised for its market value within that time is treated as liquid for this purpose. Therefore, if the constitution specifies a longer period for satisfying withdrawal requests, the types of property that will be considered liquid for this purpose expands.

On this test it is clear that a scheme may move from being liquid to being non-liquid over time, depending on the nature of its assets and the prevailing circumstances of the market for those assets. Before processing any withdrawal request, the responsible entity should check carefully that the scheme still falls within the category of liquid schemes. If the scheme's assets or the market for those assets have changed and the scheme can no longer be considered "liquid", withdrawal cannot be permitted except in accordance with the constitution and sec 601KB to 601KE.[49]

Withdrawal from non-liquid schemes

If the scheme is not liquid within the meaning of sec 601KA(4), any withdrawal entitlement must be set out in the scheme constitution, and withdrawal must be carried out in accordance with the requirements of the constitution and sec 601KB to 601KE.[50] The responsible entity is prohibited from allowing withdrawal except on this basis.[51]

The offer

Section 601KB allows the responsible entity to offer members an opportunity to withdraw, wholly or partly, from the scheme to the extent that particular assets are available and able to be converted to money in time to satisfy withdrawal requests made in response to the offer. In making an offer, the responsible entity will need to have regard to its obligation of impartiality, contained in sec 601FC(1)(d). In light of that section, it would appear that an

48. Section 601KA(4).
49. Section 601KA(3)(b).
50. Section 601KA(2).
51. Section 601KA(3)(a).

offer must be made on the same terms to all members of a class, and may be made to one class only if to do so is not unfair to members of other classes. The offer must be in writing and must specify:

- the period (of not less than 21 days) for which the offer remains open
- the assets to be used to satisfy requests, and the amount expected to be available to meet requests, and
- the method, fixed by sec 601KD, for dealing with requests where the money available is insufficient to satisfy all requests.[52]

The offer must be made in accordance with the procedures set out in the constitution or, if the constitution is silent, by giving a copy to all members, or to all members of the relevant class as the case may be. A copy of the offer must be lodged with ASIC.[53]

Only one withdrawal offer may be open at any time.[54]

Requests received in response to an offer must be held until the offer closes, and then satisfied within 21 days of that date.[55] If the withdrawal requests exceed the amount available to fund them, requests must be satisfied proportionately in accordance with the formula set out in sec 601KD.

Cancelling the offer

A responsible entity may cancel an offer before it closes if the offer contains a material error, and must cancel the offer before it closes if it is in the best interests of the members to do so.

Any procedures contained in the constitution for cancelling an offer must be followed.[56] If the constitution is silent, cancellation can be effected by giving notice of the cancellation in writing to members to whom the offer was made.[57] Notice of the cancellation must also be given to ASIC.[58]

Access to information

The responsible entity of a registered scheme may be required to provide information about the scheme to members and prospective members under the securities laws (including the continuous disclosure rules) or the periodic disclosure laws contained in Chapter 2M and discussed in Chapter 4 above. Members and others may have access to information about the scheme in other circumstances, which are summarised here.

52. Section 601KB(3).
53. Section 601KB(5).
54. Section 601KC.
55. Section 601KD.
56. Section 601KE(2)(a).
57. Section 601KE(2)(b).
58. Section 601KE(3).

Inspection of the registers

Section 173 provides for unrestricted access to a register of members or a register of option holders maintained under Chapter 2C. Members may inspect the registers without charge, while outsiders may be charged a fee.

Minutes of members' meetings

Section 253N requires the responsible entity to ensure that the minute books for meetings of scheme members are open for inspection by members free of charge.

Order for inspection of books

Under Part 2F.3 of the Corporations Law, scheme members have a right to apply to the Court for an order for inspection of the books of the scheme. Section 247A(1) provides that, on application by a member, the Court may make an order:

- authorising the applicant to inspect the books of the scheme, or
- authorising another person (whether a member or not) to inspect books of the scheme on the applicant's behalf.

The Court may only make the order if it is satisfied that the applicant is acting in good faith and that the inspection is to be made for a proper purpose.[59]

"Books" is defined widely in sec 9 to include "a register, any other record of information, financial reports or financial records, however compiled, recorded or stored, and a document".

The inspection right extends only to "books of the scheme". It may be difficult to determine whether a particular document is a book of the scheme, or of the responsible entity itself. In the context of a trust beneficiary's right to inspect trust documents, which is discussed briefly below, the difficulties raised by this issue are the subject of extensive judicial and academic discussion.[60]

Section 247B permits the Court to make ancillary orders, including orders limiting the applicant's right to make copies and limiting the use to which the information obtained may be put. Section 247C restricts disclosure of the information obtained.

Beneficiary's right to inspect trust accounts and documents

Where the scheme is structured as a trust, members (as beneficiaries) are entitled to inspect the trust accounts and trust documents, except to the extent that the trust deed provides otherwise.[61] This right may be wider than that which arises under Part 2F.3 of the Corporations Law.

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59. The good faith/proper purpose requirement is discussed in Ford, Austin and Ramsay [10.430].
60. See *Jacobs' Law of Trusts* [1716]; Dal Pont and Chalmers *Equity and Trusts in Australia and New Zealand* (1996), 461.
61. See *Tierney* v *King* [1983] 2 Qd R 580; *Hartigan Nominees Pty Ltd* v *Rydge* (1992) 29 NSWLR 405.

Members' right to seek removal of the responsible entity

A single member has standing under sec 601FN to make application to the Court for appointment of a temporary responsible entity if the scheme's existing responsible entity does not meet the requirements of sec 601FA. Significantly, a single member also has standing under reg 5C.2.02 to make application for appointment of a temporary responsible entity if the member "reasonably believes that the appointment is necessary to protect scheme property or the interests of members of the scheme". These provisions are discussed in Chapter 4 above.

Members' remedies

This part examines the members' statutory remedies for breach by the responsible entity and others of Chapter 5C of the Corporations Law. The first section deals with those provisions under which an individual member has standing to bring an action for breach of the statute. These remedies have been discussed, in part, in Chapters 5 and 7 above, and are sec 601MA, 601MB, 1324 and 1325.

Where the scheme is structured as a trust, the statutory remedies will sit along side the member's substantial rights and remedies as a beneficiary. In particular, as a beneficiary, a member will have a right to compel performance of the trust, to approach the Court for determination of questions of construction and administration, to follow the trust property, and to claim in personam against a third party who has received trust property.[62]

So far as statutory remedies for breach of Chapter 5C are concerned, it may be that individual action by scheme members is unusual, except in small scale schemes in which members have a substantial investment. Otherwise, collective action problems may prove too strong a disincentive for action.[63] Under Part 9.4B and sec 1325 of the Corporations Law and sec 50 of the ASIC Act, ASIC has considerable powers to pursue recovery actions on behalf of members, and it may be that in matters of public interest ASIC is the more common litigant. ASIC's enforcement role is discussed in Chapter 9 below.

Also, where the scheme is a trust, the responsible entity will have a duty as trustee to get in trust property, that obliges it to pursue claims (where there is a reasonable chance of success) to recover compensation or profits for the scheme. Accordingly the responsible entity itself will often be required (and can be compelled) to pursue a claim against a wrongdoer in circumstances where, under the statute, individual scheme members also have a

62. *Jacobs' Law of Trusts* Chapter 23.

63. Economic theory suggests that collective action problems arise where external claimants (the members) appoint an agent who has incentives not to act in the external claimants' best interests and do not have appropriate incentives to monitor and control the delegated activities of the agent to ensure they act in their best interests". Individual members lack appropriate incentives to take action (such as suing the responsible entity) that benefits all members because those benefits are in the nature of a 'public good' and the individual member derives benefits from expenditures on monitoring and enforcement only rateably in proportion to their interest in the scheme. The problem is exacerbated by the presence of 'free riders' who wait for others to incur costs in monitoring or enforcement actions in which the free riders will benefit. See Mark Blair and Ian Ramsay "Collective Investment Schemes: The Role of the Trustee" *Australian Accounting Review* (May 1992) 10, 11.

right to do so. This may be the case particularly where the wrongdoer responsible entity has been replaced by a new responsible entity. Litigation for the benefit of scheme members by the responsible entity is discussed in the second section of this part.

However there may clearly be circumstances in which an individual member will wish to take action against a wrongdoer in respect of a contravention of the Corporations Law. In particular, if the wrongdoer responsible entity retains that office, it may be unwilling to take proceedings against itself or its officers, and ASIC may decide (on the basis of its own resource allocation priorities) not to pursue the matter. In these circumstances a member may wish to pursue their individual statutory remedies.

In analysing the statutory remedies available to members, it is important to distinguish the remedy sought. Broadly speaking, the statutory remedies include the following:

- injunctive or declaratory relief, affecting the ongoing operation of the scheme
- avoidance of the subscription contract, returning to the member the member's original investment, and
- compensation or account of profits, which preserve the member's interest in the scheme and compensate, or capture the profit for, the scheme.

The type of remedy sought, as well as the basis on which it is claimed, will often determine the most appropriate proceeding.

Investors' remedies for non-compliance with the registration requirement

Section 601MB of the Corporations Law allows an investor to avoid a contract to acquire an interest in a scheme if the interest if the scheme is operated in contravention of the registration requirement in sec 601ED(5) or the offer was made in contravention of the prospectus requirements in Part 7.12.[64]

Subsections 601MB(2) and (3) are in substantially the same terms as former sec 1073(3) and (4), and sec 601MB(4)–(6) reflect former sec 1073A.

Section 601MB applies only to contracts for subscription, that is, primary issues. Offers of units for purchase, and contracts of sale, are not covered. This is despite the fact that the definition of "managed investment scheme" in sec 9 clearly contemplates that a person may become a member of a scheme either by being a contributor to the scheme or by acquiring interests in the secondary market. However note the operation of sec 1030(1)(b), under which, if the interests were originally allotted or issued for the purpose of on-sale, then for all purposes (including sec 601MB) a person accepting an offer for sale is deemed to have subscribed for the interests.

Under sec 601MB(1), the contract is *voidable* at the option of the subscriber, by notice in writing to the offeror. The predecessor section was introduced into the Corporations Law to reverse the position under the former Companies Code sec 171, that a contract made in these circumstances was void ab intitio: see *Hurst & Ors* v *Vestcorp Ltd* (1988) 6 ACLC 286. The relevant Explanatory Memorandum said, in relation to the predecessor provision,

64. Section 601MB(1).

"under the [companies codes], it appears that the effect of an illegal offer or issue of a prescribed interest is to render the contract void. This may have adverse effects for the interest holder. On the other hand it is considered a fair result for the offeror or issuer of the interest, who is responsible for the breach, to bear the consequences of that illegality".[65]

The procedure now included in sec 601MB(4), that allows the offeror to apply to the Court for an order affirming the contract, was introduced into the Corporations Law (as former sec 1073A) by the *Corporations Legislation Amendment Act (No 2) 1991*. Subsection 601MB(2) provides that, once a notice is given by a subscriber, the obligations of the parties under the contract are suspended, giving the offeror the opportunity to apply within 21 days (or such longer period as the Court allows) to the Court under sec 601MB(4).[66] If the offeror does not make an application, the contract is avoided at the expiration of 21 days after the notice was given. If an application is made, the contract is avoided when the application and any appeals are finally disposed of or determined.[67]

On an application under sec 601MB(4), the Court may declare the notice given by the subscriber to "have had no effect", if the Court is satisfied "that, in all the circumstances, it is just and equitable to make the declaration".[68]

Section 601MB does not contain any limit on the time in which the application for avoidance may be made. In *Lutre Pty Ltd* v *Ellison*,[69] an application was made under sec 1073A(1) after a considerable delay from the time when the subscriber became aware of facts sufficient to alert him to the possibility of the right to avoid the contract. The Court declared that the sec 1073(2) notice was ineffective as the right to avoid the contract was said to have been lost and the delay led the operator to believe that he was adhering to the contract. Section 1073(2) did not create an irreversible situation; it gave the subscriber a choice to avoid or not avoid the contract. A decision not to avoid the contract meant that at some stage the person would be deemed to have affirmed it. If the contract could never be affirmed, it could be avoided years after it had been entered into, notwithstanding the fact that the rights of third parties may have intervened.

As an alternative to proceeding under sec 601MB, it may be possible for an investor to pursue a remedy under sec 1325. Section 1325 applies for breaches of Part 7.12 and, by operation of reg 7.11.07, Chapter 5C. The types of orders available under sec 1325(5) include orders declaring contracts void, varying contracts, requiring refunds or returns of property, and for damages. The time limit for an action under sec 1325 is six years.[70]

Claims for breach of the provisions of Chapter 5C

A person who is a member of a registered scheme at the time the proceedings are commenced, may bring an action under sec 601MA against a person who is the responsible entity of the scheme at the time the proceedings are commenced, for breach of Chapter 5C.

65. Supplementary Explanatory Memorandum to the Corporations Bill 1988 (House of Representatives), para 221–2.
66. Section 601MB(4) and (5).
67. Section 601MB(2)(b).
68. Section 601MB(6).
69. (1998) 16 ACLC 231.
70. Section 1325(4).

A person who suffers loss or damage as a result of a contravention by any person of a provision of Chapter 5C may bring an action against that person and any person involved in the contravention, under sec 1325.

A person whose interests have been, are, or would be affected by a contravention of a provision of the Corporations Law, including Chapter 5C, may seek an injunction against the person and any person involved under sec 1324.

The liability provisions

Section 601MA(1) provides that:

> A member of a registered scheme who suffers loss or damage because of conduct of the scheme's responsible entity that contravenes a provision of this Chapter may recover the amount of the loss or damage by action against the responsible entity whether or not the responsible entity has been convicted of an offence, or has had a civil penalty order made against it, in respect of the contravention.

Section 1325, which applies by operation of reg 5C.11.07, is in broader terms. Significantly, subsection (2) provides that:

> The Court may, on the application of a person who has suffered, or is likely to suffer, loss or damage because of conduct of another person that was engaged in in contravention of [Chapter 5C], or on the application of the Commission in accordance with subsection (3) on behalf of such a person or 2 or more such persons, make such order or orders as the Court thinks appropriate against the person who engaged in the conduct or a person who was involved in the contravention (including all or any of the orders mentioned in subparagraph (5) if the Court considers that the order or orders concerned will compensate the person . . . in whole or in part for the loss or damage, or will prevent or reduce the loss or damage suffered, or likely to be suffered, by such a person.

The Explanatory Memorandum suggests that sec 601MA was intended to be the principal gateway for litigation by scheme members arising out of a breach of Chapter 5C.[71] However sec 1325 is wider in scope than sec 601MA, and it may be that sec 1325 entirely subsumes the operation of sec 601MA.

The sections reflect in part the drafting of sec 1005 of the Corporations Law and sec 82 of the *Trade Practices Act 1974* (Cth), and it is expected that case law interpreting the corresponding elements of those provisions will be relevant in interpreting sec 601MA and 1325.

Section 601MA gives a member a right of action against the responsible entity only. Unlike sec 1325, liability under sec 601MA does not extend to persons involved in a contravention of Chapter 5C. The Explanatory Memorandum to sec 601MA states that:

> The right to bring a statutory action will not extend to actions against other persons involved in the operation of the scheme (such as directors, compliance committee members or any entity engaged by the responsible entity to have custody of the scheme property). A member's right to bring an action against these persons will depend on the general law and will not be set out in the Law. This

71. See *Senate Hansard* 23 June 1998, 3427–30.

> will preserve the concept of a single responsible entity responsible to members for the operation of the scheme.[72]

However sec 1325 will extend liability to those involved in a contravention of Chapter 5C. Section 1325 also permits a right of action against any person who contravenes a provision of Chapter 5C, not just the responsible entity.

Standing

Only a person who is a member of a registered scheme has standing to bring an action under sec 601MA. "Member" is defined in sec 9 as "a person who holds an interest in the scheme". The person must be a member at the time the action is brought — former members do not appear to have standing under the section. This is consistent with the view expressed by Brooking J in *Young* v *Murphy* that a person who had sold their units in a trust after the wrongdoing but before recovery would not have any right to share in the proceeds of any claim for breach of trust.[73]. Further, it reflects the interpretation of the standing of former members of companies conferred under sec 246AA (the oppression remedy), which confers standing on "a member" of a company.[74]

There is no such restriction on standing under sec 1325.

Persons against whom a claim can be brought

Section 601MA allows the member to bring an action against the scheme's responsible entity. It appears that the person sued must be the responsible entity at the time the suit is commenced, and not just at the time of the wrongdoing. Certainly this interpretation is open on the words of the section, although such a restriction may reduce its utility. However the fact that sec 1325 permits an action against any person who contravenes Chapter 5C, and any person involved in a contravention, means that an action is possible against a former responsible entity under that section, rather than under sec 601MA.

By operation of sec 601FB(2), the acts and omissions of any agent or appointee are treated as the acts or omission of the responsible entity for the purpose of determining whether there is a liability to the members. If loss or damage has resulted from an act or omission by an agent, it may be that sec 601FB(2) permits a member to commence an action against the responsible entity under sec 601MA or 1325 to recover compensation in respect of it.

72. Explanatory Memorandum to the *Managed Investments Bill 1997*, para 14.2.

73. *Young* v *Murphy* (1994) 13 ACSR 722 at 729

74. Section 246AA is interpreted as giving standing to a person who is a member at the time the action is commenced, even if they were not a member at the time of the wrongdoing. Former members do not have standing under sec 246AA. See Elizabeth Boros *Minority Shareholders' Remedies* (1995) 123.

Procedure, joinder and compensation

Sections 601MA and 1325 each allow the person claiming under them to recover the amount of the loss or damage suffered by the person because of the contravening conduct of the responsible entity. This raises complex issues about the proper measure of compensation, particularly where the contravening conduct amounted to a breach of trust by the responsible entity. In *Re Dawson* Street J distinguished the duty to compensate for breach of trust from an action for common law damages:

> The obligation of a defaulting trustee . . . is of a personal character and its extent is not to be limited by common law principles governing remoteness of damage . . . if a breach has been committed then the trustee is liable to place the trust estate in the same position as it would have been in if no breach had been committed. Considerations of causation, foreseeability and remoteness do not readily enter into the matter . . .
>
> [T]he obligation . . . is of a more absolute nature than the common law obligation to pay damages for tort or breach of contract . . . Moreover the distinction between common law damages and relief against a defaulting trustee is strikingly demonstrated by reference to the action form of relief granted in equity in respect of breach of trust. The form of the relief is couched in terms appropriate to require the defaulting trustee to restore to the estate the assets of which he deprived it.[75]

It may be that, where the contravention of a provision of Chapter 5C is also a breach of trust by the responsible entity, the proper compensation is that necessary to effect restitution.

Section 601MA contemplates a direct action by a member against the responsible entity for compensation for any loss or damage suffered by the member. However because the member is (in most if not all cases) a beneficiary under a trust, and the conduct complained of may in many circumstances also amount to a breach of trust, application of the section raises two threshold issues. First, must a single member pursue a representative claim, or join all other members in the claim? Secondly, should compensation be paid directly to the member, or as an accretion to the trust fund?

Where the conduct complained of amounts to a breach of trust affecting all members in the same way, the appropriate compensation would appear to be restitution to the trust fund.[76] In the *Occidental* case, Brooking J refers with approval to the following passage from the American text *Scott on Trusts*:

> If a suit is brought against a trustee by one or more of several beneficiaries, it is important to protect the interests of the other beneficiaries and it is also important that the decision should be binding on the other beneficiaries in order to protect the trustee from further suits by them. Hence the other beneficiaries should have an opportunity to be heard. Ordinarily they should be joined as parties, either as plaintiffs or as defendants, if their interests would be affected by the decree. They need not be joined if their interests are sufficiently represented by one or more parties to the suit.[77]

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75. [1966] 211, 214–6.
76. See *Young* v *Murphy* (1994) 13 ACSR 722; *Australian Securities Commission* v *AS Nominees Ltd* (1995) 18 ACSR 459; *Occidental Life Insurance Co Ltd* v *Bank of Melbourne* (1993) 7 ANZ Insurance Cases ¶ 61–201.
77. (1993) 7 ANZ Insurance Cases ¶ 61–201.

In light of the policy considerations articulated in *Scott on Trusts* and accepted by Brooking J in the *Occidental* case, it seems appropriate that in cases where the loss or damage sustained by the member is a result of a diminution in the value of the scheme assets, the proceedings should be representative proceedings and any compensation ordered form part of the scheme property for the benefit of all of the members.

In an action under sec 601MA the complaining member would appear to bear the burden of the costs of the action, although it may be open to the court to make an order along the lines of the procedure developed in *Wallersteiner* v *Moir (No. 2)*.[78] In view of the potential liability for costs, and if the benefit of the action is to accrue to the scheme generally and not to the scheme members individually, members may prefer to explore claims other than under sec 601MA. For example, where the conduct complained of is a breach of one of the civil penalty provisions (in particular, sec 601FC), the members may prefer to require the responsible entity to bring an action under sec 1317HD.[79]

Limitation period

Section 601MA(2) provides that an action under sec 601MA(1) must be begun within 6 years after the cause of action arises. A similar limitation period applies to claims under sec 1325.[80] It is suggested in the context of sec 1005 that a cause of action will arise when the loss or damage is sustained as a result of the contravening conduct, and not at the time the conduct takes place.

Preservation of general law remedies

Section 601MA(3) provides that the section does not affect any liability that a person has under any other provisions of this Law or under other laws. Alternative sources of liability for the responsible entity include under the civil penalty provisions in Part 9.4B, under Part 9.4, and under the general law of trusts (where the responsible entity is a trustee for scheme members).

Injunctive relief under sec 1324

Section 1324 gives the Court the power, on the application of ASIC or of "a person whose interests have been, are or would be affected by the conduct", to restrain breaches of the Corporations Law by injunction.[81] In addition, where the Court has power under the section to grant an injunction restraining a person from engaging in particular conduct,

78. [1975] QB 373; see also *Farrow* v *Registrar of Building Societies* [1991] 2 VR 589.
79. In schemes that are trusts, the responsible entity is required, as trustee, to pursue any action to get in trust funds, unless the action is futile. Since the responsible entity takes action for the benefit of the members, it can sue even if it was a party to the breach of trust or some other breach of trust: see below.
80. Section 1325(4).
81. Section 1324(1).

or requiring a person to do a particular act or thing, the Court may, either in addition to or in substitution for the grant of the injunction, order that person to pay damages to any other person.[82]

Clearly the provision is a useful one to restrain breaches of Chapter 5C. Interestingly, Ford and Hardingham have expressed the view that the section may be wide enough to confer standing on scheme members to seek an injunction restraining breach of the duties owed by the officers of the responsible entity to the responsible entity itself under sec 232.[83]

The fact that the principal sources of statutory duty on which an application for relief under sec 1324 are likely to be based, in this context, are civil penalty provisions would not appear to preclude an application by a person other than ASIC under sec 1324.[84]

The available relief

Relief is available under sec 1324 where a person has engaged, is engaging or is proposing to engage in conduct that constituted, constitutes or would constitute:

- a contravention of a provision of the Corporations Law
- attempting to contravene a provision of the Corporations Law, or
- involvement in a contravention in the manner discussed above.

In these circumstances the Court may "grant an injunction, on such terms as the Court thinks appropriate, restraining the . . . person from engaging in the conduct and, if in the opinion of the Court it is desirable to do so, requiring that person to do any act or thing".

In addition, under sec 1324(10), where the Court has power under sec 1324(1) to grant an injunction "the Court may, either in addition to or in substitution for the grant of the injunction, order that person to pay damages to any other person".

The question of whether a claim for damages is available in respect of completed conduct is unclear. In *Permanent Trustee Australia Ltd* v *Perpetual Trustee Co Ltd*,[85] Cohen J held that the Court had power to award damages under this section even where there was no continuing conduct capable of being restrained by injunction. His Honour held that the power to award damages under the equivalent of sec 1324(10) "stands alone, unaffected by the principles which have been applied to the powers to grant damages under Lord Cairns Act and its successors".[86] Therefore in that case the ASC was entitled to seek an order under the equivalent of sec 1324(10) even though "there was no prospect of a further offence or contravention of" the statute.[87]

82. Section 1325(10). On sec 1324 generally, see Elizabeth Boros *Minority Shareholder Remedies* (1995) 213–5; Robert Baxt "Will Section 574 of the Companies Code Please Stand Up! (And will Section 1324 of the Corporations Act Follow Suit?)" (1989) 7 *Company and Securities Law Journal* 388; Pamela Hanrahan "Distinguishing Corporate and Personal Claims in Australian Company Litigation" (1997) 15 *Company and Securities Law Journal* 21, 39–40.

83. Ford and Hardingham 68.

84. See *Airpeak Pty Ltd* v *Jetstream Ltd* (1997) 15 ACLC 715; cf *Mesenberg* v *Cord Industrial Recruiters Pty Ltd* (1996) ACLC 519.

85. (1994) 15 ACSR 722.

86. Ibid, 727.

87. Ibid, 728.

In *Executor Trustee Australia & Anor* v *Deloitte Haskins and Sells &Ors* [88] Perry J took a contrary view, holding that the power to award damages could not be invoked independently of an application for an injunction.

In *Gracia & Ors* v *Qcapt & Ors*[89] Master Bredmeyer in the Supreme Court of Western Australia considered the conflicting authority and decided that, until the matter was resolved by an appellate court, the plaintiff's application for damages under sec 1324 without a properly based plea for injunction was not so "manifestly groundless" that it could not possibly succeed, and therefore should not be struck out. The Master expressed the view in obiter that it was arguable that sec 1324 should be given a wide interpretation, to permit the grant of damages as an alternative to an injunction and without one being sought.[90]

Standing

Section 1324 confers standing on ASIC and any person "whose interests have been, are or would be affected by the conduct" to seek relief under it. In *Broken Hill Pty Co Ltd* v *Bell Resources Ltd,* Hampel J expressed the view in interpreting the predecessor section that a broad approach should be adopted so as to allow a wide range of persons who might have a specific interest to bring proceedings for injunctive relief.[91]

Where the wrongdoer's contravening conduct results in a loss to the trust fund, the responsible entity as trustee has standing to bring proceedings, particularly given its duty, as trustee, to get in trust assets for the purposes of the trust.[92] Similarly current members of the scheme would appear to have standing where the wrongdoer's conduct gives rise to a liability to make redress to the scheme.[93]

The question as to the standing of past members is more complex. It may be that it depends on whether a past member can be entitled to share in any compensation once they have left the scheme.

Generally speaking, where a claim is made by a trustee for redress for breach of trust (by the trustee or a stranger), the amount recovered is held as an accretion to the trust fund for the benefit of the members at the time the amount is paid. In *Young* v *Murphy* Brooking J, although not required to decide the issue, expressed the view that it seemed unlikely that any person who had sold their units in the trust after the wrongdoing and before recovery would have any rights with respect to that accretion.[94] Phillips J held that "it seems to me that the former unit holders who sought and obtained redemption of their units according to the trust deeds, abandoned any claim thereafter to participate in the trust

88. (1996) 14 ACLC 1789.
89. (1998) 16 ACLC 1134.
90. Ibid, 1138.
91. (1984) 8 ACLR 609 at 613.
92. See above, applying by analogy the principles conferring standing on a trustee to take action for breach of trust.
93. ALRC/CASAC took the view that, under the previous law, investors in prescribed interest schemes could protect their rights by seeking injunctions to require compliance with the law or to prevent a breach of the law under sec 1324: ALRC/CASAC *Report No 65* para 11.32.
94. (1994) 13 ACSR 722 at 729.

funds".[95] However he did leave open the possibility that a former member could argue that they gained a right, before redemption, for compensation which they did not lose on redemption: in this case the trustee would hold the fruits of the litigation for all the beneficiaries affected by the losses incurred and retaining rights in the matter, which *ex hypothesi* would include the former unit holders.[96]

If the view is taken that former members could never have a right to share in the fruits of any action maintained under sec 1324, then it seems unlikely that a court would consider them as persons with standing under that section. However the narrow door left open by Phillips J in *Young* v *Murphy*, suggesting that in some circumstances former members may retain a right to those fruits, may if it were accepted as a basis for a claim be sufficient to establish standing under sec 1324.

Relief from liability

The court may be in a position to relieve an officer from liability under sec 1324(10), under sec 1318. However the court's power to grant this relief does not extend to the responsible entity itself, its employees or compliance committee members.[97]

Recovery on behalf of the scheme by the responsible entity

The foregoing discussion focused on the statutory remedies available to scheme members individually. However given the relatively high potential for collective action problems in the managed investments context, it may be more likely that recovery for the benefit of members will occur at the instigation of ASIC or the scheme's responsible entity.

ASIC's powers to seek orders for recovery are discussed in Chapter 9 below. Where a civil penalty order is made with respect to a contravention, the Court may order the wrongdoer to pay compensation to the scheme, under sec 1317HA(1). If the person ordered to pay compensation is at the time of the order the scheme's responsible entity, the amount ordered must be transferred to scheme property. If another person (including a former responsible entity) is ordered to pay compensation, the responsible entity may recover the compensation on behalf of the scheme.[98]

The responsible entity has standing to intervene in an application for a civil penalty order against a person in relation to a contravention, and is entitled to be heard on the question of compensation.[99]

A similar procedure applies for orders for compensation made in connection with criminal proceedings for breach of the civil penalty provisions, under sec 1317HB.

Significantly, the responsible entity of a scheme may bring proceedings under sec 1317HD to recover damages, or obtain an account of profits, for the scheme where

95. Ibid, 742.
96. Ibid.
97. Section 1318(4).
98. Section 1317HA(1A).
99. Section 1317HA(2) and (3).

there has been a breach of the civil penalty provisions. That section states that, if a person contravenes a civil penalty provision, the person must account to the scheme for:

- if that person or another person has made a profit because of the act or omission constituting the contravention — an amount equal to the amount of the profit, and
- if the scheme has suffered loss or damage as a result of that act or omission — an amount equal to the amount of that loss or damage.[100]

The amount for which the person is liable may be recovered as a debt.[101] The responsible entity is given standing to recover the debt on behalf of the scheme.[102]

This right to recover under sec 1317HD does not depend on an application for a civil penalty order or criminal proceedings having been commenced. If the responsible entity itself is the wrongdoer, it must transfer the amount for which it is liable to scheme property. If anyone else is liable, the responsible entity may recover the amount as a debt on behalf of the scheme.

Of course, where the responsible entity is a trustee, its ability to bring an action for the benefit of the members does not depend on the statute. Under general principles of trust law a responsible entity that is a trustee may commence proceedings against a stranger or former trustee for recovery on behalf of the members. In *Young* v *Murphy* Brooking J noted 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 a risk of himself committing a breach of trust if he fails to do so . . . His obligation to take the proceedings (unless they would be futile) is part of his duty to get in the trust estate, which includes rights of action against co-trustees or former trustees and strangers for breach of trust. This is clear as a matter of both principle and authority. Moreover, since the trustee will take the proceedings for breach of trust for the benefit of the beneficiaries, he can sue even if he was a party to the breach of trust or some other breach of trust.[103]

In such an action the responsible entity would not be required to join the scheme members as parties, where it can be seen to sufficiently represent their interests. However if, for example, the proceedings raise questions between one member and another, or questions between the members and the responsible entity bringing the claim, the members may need to be joined. Any proceeds of the claim are held by the responsible entity as an accretion to the trust fund.

Relief from liability

Under sec 1317JA, a court has power to relieve a person from liability for contravention of a civil penalty provision, where it appears to the court that the person has acted honestly

100. Section 1317HD(1).
101. Section 1317HD(1A).
102. Section 1317HD(3).
103. Ibid, 725.

and that, having regard to all the circumstances of the case, they ought fairly to be excused. The power to grant relief in these circumstances reflects the court's power under sec 1318 to grant relief from liability for negligence, default, breach of trust or breach of duty in civil proceedings, and the power conferred by trustee legislation in each State on the court to excuse trustees of breach of duty.[104]

Exoneration by the court is available in any proceedings for a contravention of a civil penalty provision, including applications for a civil penalty order under sec 1317EA and applications by the responsible entity for damages or an account of profits under sec 1317HD. However it is not available in relation to criminal proceedings under Division 4 of Part 9.4B, except so far as the proceedings relate to the question of whether the court should make an order under sec 1317HB for the payment of compensation.[105]

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104. Eg *Trustee Act 1958* (Vic), s 67. For a discussion of the principles in accordance with which this discretion is exercised, see generally Ford, Austin and Ramsay [8.420] and Dal Pont, Chalmers and Maxton *Equity and Trusts in Australia and New Zealand* (1996) 544–6.

105. Section 1317JA(1).

Chapter 9

Role and Powers of ASIC

This chapter examines the role of ASIC in administering and supervising compliance with Chapter 5C, and its powers to monitor and control the management and operation of registered schemes. ASIC's powers in relation to establishing a scheme (including its licensing powers and powers in relation to the content of constitutions and compliance plans) are discussed in Chapter 3 above. This chapter begins with a discussion of ASIC's power to grant exemptions from, or modification of, Chapter 5C, generally or in a specific case. It then considers ASIC's surveillance powers and, finally, summarises the forms of administrative and litigious action that are available to ASIC where a breach of the law is discovered.

Exemptions and modifications

Part 5C.11 confers on ASIC the power to exempt a person from compliance with any of the provisions of Chapter 5C, or to modify its operation in relation to a person. The Part also allows for the modification of Chapter 5C "or any other provisions of this Law relating to securities" by regulation.

ASIC has power, under sec 601QA(1), to grant an exemption from a provision of Chapter 5C, or declare that Chapter 5C applies as if specified provisions were omitted, modified or varied in the manner specified in the declaration.

Section 601QA(5) provides that, for these purposes, a reference to the provisions of Chapter 5C includes a reference to the regulations made for the purposes of the Chapter, and to definitions in the Law or the regulations that apply to the Chapter or the regulations.

ASIC's power is granted in broad terms. Under sec 601QA(2) the declaration or exemption may:

- apply to all or specified provisions of Chapter 5C
- apply to all persons, specified persons or a specified class of persons
- relate to all interests, specified interests or a specified class of interests in managed investment schemes, and
- relate to any other matter generally or as specified.

Therefore ASIC's power extends to making class orders of general application.

The power reflects sec 728 and 730, which allow ASIC to grant exemptions from and modifications of the takeover provisions, and sec 1084, allowing for exemption from or modification of the provisions of Divisions 2, 3, 3A, 4 and 6 of Part 7.12, which regulate the offer of securities for subscription or purchase. The case law on the exercise by ASIC of its discretion under these sections will be relevant in interpreting sec 601QA also.

The broad powers conferred on ASIC by sec 601QA are a matter for some disquiet as a matter of constitutional law, and their exercise may be subject to challenge if it is inconsistent with Westminster principles.

A decision by ASIC under sec 601QA to exempt a person from complying with, or modify the operation of, the Chapter would appear to be reviewable by the Administrative Appeals Tribunal pursuant to sec 1317B.[1]

ASIC policy and procedures

The policy in accordance with which ASIC exercises its powers under sec 601QA is set out in ASIC Policy Statement 136. ASIC states that its policy is to "consider giving relief to address atypical or unforeseen circumstances and unintended consequences of the Law relating to managed investment schemes".[2]

ASIC takes the view that it "may modify the Law by imposing additional obligations or restrictions . . . [and] can give exemptions and modifications even though we have not had any application for them".[3]

Applications for relief must be made in accordance with ASIC Policy Statement 51. A list of class orders and pro formas made by ASIC pursuant to sec 601QA is contained at ASIC Policy Statement 136.91.

ASIC is required to make any exemption or declaration in writing and must publish notice of it in the *Gazette*.[4]

Conditions

Section 601QA(3) allows ASIC to impose conditions on an exemption. It states that "a person to whom a condition specified in an exemption applies must comply with the condition". ASIC may apply to the Court for an order for compliance.

Section 601QA(3) does not appear to extend to declarations made in accordance with sec 601QA(1)(b). This would suggest that modifications granted under that paragraph (as distinct from exemptions granted under sec 601QA(1)(a)) must be unconditional. However class orders made by ASIC under sec 601QA(1)(b) have purported to impose conditions.

Modification by regulation

Chapter 5C contains provision for its modification by regulation. Section 601QB states that "the regulations may modify the operation of [Chapter 5C] or any other provisions of this Law relating to securities in relation to a managed investment scheme or all managed investment schemes of a specified class".

1. See *Hawker de Havilland Ltd & Ors* v *ASC & Ors* (1992) 10 ACLC 34.
2. ASIC Policy Statement 136.2.
3. SIC Policy Statement 136.17.
4. Section 601QA(4).

The section does not appear to extend to granting exemptions (c.f. ASIC's power under sec 601QA) although it has purportedly been used in this way in Regulation 5C.11.01. Several modifications of the Law have been made by regulation.[5]

The fact that the law includes a general power to modify by regulation may suggest that ASIC's class order power should be read down, as not extending to relief of general application.

Surveillance and information gathering

ALRC/CASAC, in *Report No 65*, took the view that "to promote investor confidence and provide adequate investor protection, the regulator must have effective information gathering powers".[6] ASIC has various surveillance and information gathering powers available to it under the Corporations Law and the ASIC Act, including:

- its power to conduct surveillance checks under sec 601FF
- its power to require information from a dealer licensee under sec 788
- its power to require information about the compliance plan under sec 601HD, and
- its investigation and information gathering powers under Part 3 of the ASIC Act.

Surveillance checks

Under sec 601FF, ASIC is given the power to check, from time to time, whether the responsible entity of a registered scheme is complying with the scheme's constitution and compliance plan and the Corporations Law. The Note to the section indicates that ASIC may exercise the powers set out in Division 3 of Part 3 of the ASIC Act in performing these checks. Division 3 of Part 3 relates to inspection of books.

ASIC has powers of investigation under Part 3 generally where it has reason to suspect that (among other things) a contravention of the Corporations Law may have been committed. Section 601FF represents an additional power for ASIC, in that it is not required to have reasonable suspicion of non-compliance before it exercises its powers under that section. ASIC's power to examine persons under Division 2 of Part 3 is limited to investigations under Division 1 of Part 3 of ASIC and accordingly would not appear to extend to investigations initiated under sec 601FF.

Section 601FF(2) requires the responsible entity and its officers to take all reasonable steps to assist ASIC in carrying out a check under subsection (1). Regulation 5C.2.01 requires agents of the responsible entity to take all reasonable steps to assist the entity and ASIC when ASIC is conducting a compliance check.

5. See regs 5C.11.02–5C.11.08.
6. ALRC/CASAC *Report No 65* para 14.7.

Information from a dealer licensee

Under sec 788, the responsible entity as the holder of a dealers licence must "lodge such written information or statements in relation to" the managed investment scheme "as ASIC from time to time directs". ASIC can require that the statement be audited before it is lodged.[7]

Information about the compliance plan

ASIC may direct the responsible entity to give it information about the arrangements contained in the compliance plan, under sec 601HD.

Investigative powers under the ASIC Act

Part 3 of the ASIC Act gives ASIC significant powers to investigate matters and compel the production of information. ASIC may initiate an investigation under Division 1 where it has reason to suspect that there may have been a contravention of the Corporations Law or of another law that concerns the management or affairs of a managed investment scheme.[8] If ASIC, on reasonable grounds, suspects or believes that a person can provide information relevant to a matter that it is investigating or is to investigate, it can require the person to give all reasonable assistance and to appear for examination.[9] That examination is conducted in accordance with Division 2 of Part 3 of the ASIC Act.

All books required to be kept in relation to the scheme under the Corporations Law are open for inspection by ASIC.[10] In addition, ASIC has certain powers to require the production of books, under Division 3 of Part 3. These powers can be exercised by ASIC for the purposes of the performance of its functions and powers, to ensure compliance with the Corporations Law, in connection with an investigation under Division 1, or in relation to an alleged or suspected contravention of law.[11] In similar circumstances, ASIC can require information about dealings in interests, under Division 4.

ASIC also has power to conduct hearings for the purposes of the performance or exercise of any of its functions and powers under the Corporations Law and related statutes. The rules governing such hearings are contained in Division 6.

ASIC's powers under Part 3 of the ASIC Act have been the subject of considerable commentary.[12]

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7. Section 788(2). ASIC's powers under sec 788 are discussed in Baxt, Black and Hanrahan.
8. ASIC Act sec 13(1). The responsible Minister may direct ASIC to undertake an investigation in certain circumstances, under ASIC Act sec 14.
9. ASIC Act sec 19.
10. ASIC Act sec 29.
11. ASIC Act sec 28.
12. John Kluver "ASC Investigations and Enforcement: Issues and Initiatives" (192) 15 *UNSW Law Journal* 31; Ford Austin and Ramsay [3.170]–[3.210].

Enforcement

Where ASIC discovers a breach of the Corporations Law in relation to a registered scheme, it has various options available to it. Broadly speaking, these options can be divided into administrative and litigious action. Administrative actions are actions that ASIC can take that affect the position of the responsible entity, scheme members or others without recourse to the courts. Litigious actions are those actions that ASIC has standing to bring, seeking remedial orders from the court.

The administrative and litigious powers of ASIC have been discussed, for the most part, throughout the text. They are collected together here by way of summary. The administrative actions available to ASIC include:

- obtaining an enforceable undertaking, under Part 3A of the ASIC Act
- revoking or suspending the responsible entity's dealers licence, under Division 5 of Part 7.3
- varying the conditions or restrictions imposed under the dealers licence, under Division 1 of Part 7.3
- requiring modifications to the compliance plan, under sec 601HE, and
- deregistering the scheme under sec 601PB.

ASIC has standing to seek orders from a court in relation to a contravention of the Corporations Law under various provisions, including:

- sec 1315 and sec 49(2) of the ASIC Act, to prosecute offences
- sec 601FN or reg 5C.2.02, requesting appointment of a temporary responsible entity
- sec 1317EB, to seek civil penalty orders for breach of the civil penalty provisions, and
- sec 1323, 1324 or 1325, which allow ASIC to seek preservative orders, injunctions, and orders affecting contracts or requiring the payment of damages.

ASIC may also commence proceedings under sec 50 of the ASIC Act to enforce members' rights, for example under sec 601MA.

Accepting enforceable undertakings

Under Part 3A of the ASIC Act, ASIC is able to accept enforceable undertakings from a responsible entity in relation to any matter concerning a registered scheme.

The procedure is modeled on sec 87B of the *Trade Practices Act 1974* (Cth), and sec 201A of the ASIC Act, which allows the Corporations and Securities Panel to accept such undertakings.

If the responsible entity breaches the undertaking, ASIC can apply to the Court for orders under sec 93A(4) of the ASIC Act.

Revoking or suspending the licence

A company cannot be the responsible entity of a registered scheme unless it holds a dealers licence. ASIC has power to revoke or suspend a licence under Division 5 of Part 7.3.

Significantly, ASIC is empowered to revoke a licence without a hearing if it is satisfied that the members of the scheme have suffered, or are likely to suffer, loss or damage because the responsible entity has contravened the Corporations Law.[13]

With a hearing, ASIC can revoke the licence in a range of circumstances, set out in sec 826. These include breach of licence conditions or breach of the securities laws.

ASIC can choose to suspend, rather than revoke, the licence under sec 827.

Varying or adding licence conditions

ASIC can impose or vary licence conditions during the term of its currency.[14] This enables ASIC to impose particular controls on the conduct of a scheme (for example, by requiring the use of an independent custodian). This can be done only with a hearing, under sec 837.

Requiring modifications to the compliance plan

Section 601HE allows ASIC to require modifications to a compliance plan. Where ASIC becomes aware of some contravention, it may require modifications to the compliance plan designed to ensure that, if the provisions in the plan are carried into effect, the contravention should not reoccur. Like variations to licence conditions, this power enables ASIC to control to some degree the management functions of the responsible entity.

Deregistering the scheme

ASIC has power to deregister the scheme for certain types of non-compliance with Chapter 5C. Its power to do so is set out in sec 601PB and discussed in Chapter 10 below.

Removing the responsible entity

It was noted in Chapter 4 that ASIC can make application to the Court to remove the responsible entity if it ceases to meet the requirements of sec 601FA or if the appointment of a temporary responsible entity "is necessary to protect scheme property or the interests of members of the scheme".[15] This power is described by ALRC/CASAC as "an additional preservative remedy . . . similar to the power of [the former] Insurance and Superannuation Commissioner to apply for a court order to place a life insurance company under judicial management".[16]

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13. Section 825A.
14. Section 786(1)(b).
15. Regulation 5C.2.02.
16. ALRC/CASAC *Report No 65* para 14.20.

Instigating civil penalty proceedings

ASIC has power to instigate proceedings for a civil penalty order, where a breach of the civil penalty provisions has occurred.[17]

Under sec 1317EB, application can be made by ASIC, its delegate or a person authorised by the Minister for a civil penalty order in respect of a contravention by a person of a civil penalty provision. Where the Court is satisfied that a contravention has occurred, it must make a declaration under sec 1317EA(2) to that effect, and may also order that the person is prohibited from managing a corporation and that the person pay a pecuniary penalty to the Commonwealth of an amount not exceeding 2,000 penalty units.[18] The proceedings are civil proceedings for the purposes of the rules of evidence and procedure.[19]

Where the person has knowingly, intentionally or recklessly contravened sec 601FD, and has acted either:

- dishonestly and intending to gain, whether directly or indirectly, an advantage for that or any other person, or
- intending to deceive or defraud someone,

the person commits an offence under sec 1317FA, and is liable to prosecution. The proceedings in this case are criminal proceedings, and the person may be subject to fines of up to 2,000 penalty units, or imprisonment for up to five years, or both.[20]

Where a person has contravened a civil penalty provision, that person may be ordered to compensate the scheme for any loss or damage to, or a diminution in the value of, the property of the scheme, and may be liable to account for profits. The court may also order punitive damages in certain circumstances.[21]

Where a civil penalty order is made with respect to the contravention, the Court is empowered to order the person to compensate the scheme where loss or damage, or diminution in the value of scheme assets, has occurred.[22] The responsible entity recovers the compensation on behalf of the scheme.[23] Further, the responsible entity has standing to intervene in an application for a civil penalty order against the person, and is entitled to be heard on the question of compensation.[24]

Where the person is convicted of an offence in relation to the contravention, the criminal court may order a person to compensate the scheme if it is satisfied that the act or omission constituting the contravention caused loss or damage to, or a diminution in the

17. Section 1317EB.
18. Section 1317EA(3). A pecuniary penalty may be imposed only if the contravention is a "serious" one: sec 1317EA(5). See ALRC/CASAC *Report No 65*, para 15.10 for the relevance of the test in *Briginshaw* v *Briginshaw* (1938) 60 CLR 336 in determining whether the contravention is serious.
19. Section 1317ED.
20. Schedule 3.
21. Section 1317JC.
22. Section 1317HA(1).
23. Section 1317HA(1A).
24. Sections 1317HA(2) and (3).

value of, the property of the scheme.[25] Where criminal proceedings have resulted in a finding that the person contravened a civil penalty provision, but without the requisite intent to constitute a criminal offence, the Court can make a declaration with respect to the contravention,[26] and order compensation.[27] Again, the responsible entity recovers the amount of compensation on behalf of the scheme.[28]

Prosecuting offences

Criminal proceedings are described by ALRC/CASAC as "one of the central means of enforcing the laws regulating collective investment schemes".[29] Offences under the Corporations Law are discussed elsewhere.[30]

25. Section 1317HB(1).
26. Division 4 of Part 9.4B.
27. Section 1317HB(2).
28. Section 1317HB(3).
29. ALRC/CASAC *Report No 65* para 14.16.
30. Ford Austin and Ramsay [3.390].

Chapter 10

Deregistration and Termination of Schemes

This chapter examines the provisions of Chapter 5C that allow for, or require, deregistration of schemes. Deregistration may coincide with termination of the scheme, although it will not do so in all circumstances. Termination of schemes is governed primarily by the provisions of the scheme constitution and, where the scheme is a trust, may be directed or supervised by the Court under its inherent jurisdiction. However termination is affected by the provisions of Part 5C.9, which are also discussed here.

Deregistration

Deregistration of schemes is covered by Part 5C.10. Deregistration is significant because, if it occurs, it may result in the operator of the scheme being in breach of sec 601EB (the requirement to register certain schemes). In addition, many of the operational and structural requirements imposed by Chapter 5C only apply to registered schemes (and therefore cease to apply when a scheme is deregistered).

Deregistration may occur at the instigation of the responsible entity of the scheme, or ASIC.

Registration of a scheme does not create or incorporate that scheme, and similarly deregistration does not affect the existence of a scheme. The Explanatory Memorandum states that "deregistration will not affect any underlying legal relationships between persons involved in the operation of the scheme and scheme members".[1] A scheme may be deregistered before, during or after its winding up.

Voluntary deregistration

The responsible entity of a registered scheme may lodge an application for deregistration with ASIC under sec 601PA(1), in the circumstances set out in sec 601PA(2). Generally speaking, a responsible entity will apply for deregistration where registration is no longer required under Chapter 5C (for example, because the number of members in the scheme has fallen below 20) and the responsible entity wishes to be relieved of the obligations that apply under the Corporations Law to registered schemes.

The circumstances in which the responsible entity may apply for deregistration are set out below.

1. Explantory Memorandum, para 16.7.

With the consent of all the members, the responsible entity may apply for deregistration if the scheme has less than 20 members (calculated in accordance with sec 601ED(4)) and is not promoted by a professional promoter or one of a group of schemes the subject of a declaration under sec 601ED(3).[2] This may occur, for example, where the majority of members have withdrawn from the scheme since the time of registration. Such an application may also follow a takeover in which the bidder has been successful in acquiring all interests on issue in the scheme.

With the consent of all the members, the responsible entity may apply for deregistration if all interests on issue at the relevant time were issued under excluded issues.[3] This would occur if all the retail investors withdrew from a scheme after registration, or may be relevant where a wholesale scheme has registered for the purposes of sec 601FC(4), but that registration is no longer required.

The responsible entity may apply for deregistration if the scheme no longer falls within the definition of a managed investment scheme.[4] A scheme may cease to be a managed investment scheme if, for example, the terms on which the scheme operates are altered to give members day-to-day control over the operations of the scheme.

If ASIC is satisfied that the application for deregistration in each case complies with sec 601PA(1) and (2), it is required to give notice of the proposed deregistration on the national database and in the *Gazette*. ASIC may deregister the scheme when two months have passed from the date of the *Gazette* notice.[5] If the scheme is deregistered, ASIC must give notice of the deregistration to the applicant.[6]

Involuntary deregistration

ASIC has the power to deregister a scheme (subject to compliance with the procedural requirements in sec 601PB(2) and (3)) in certain circumstances. The procedural requirements for deregistration, and the requirements for reinstatement of registration, are discussed below.

Grounds for deregistration

ASIC may deregister a scheme in, broadly speaking, three cases:

- where the scheme has been wound up: sec 601PB(1)(f)
- where the scheme is defunct: sec 601PB(1)(e)
- where certain specified requirements of Chapter 5C are not being met in relation to the scheme: sec 601PB(1)(a)–(d).

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2. Section 601PA(2)(a).
3. Section 601PA(2)(b).
4. Section 601PA(2)(c).
5. Section 601PA(3).
6. Section 601PA(4).

Schemes that have been wound up

Winding up of schemes is provided for under Part 5C.9. Once the scheme has been wound up, ASIC may deregister the scheme in accordance with sec 601PB.[7]

Defunct schemes

ASIC also has power to deregister defunct schemes. If the scheme's annual return (required under Part 2N) is at least 6 months late, no other documents have been lodged by or on behalf of the scheme in the last 18 months, and ASIC has no reason to believe that the scheme is being operated, ASIC may deregister the scheme in accordance with sec 601PB.[8]

Schemes operating in breach of certain specified provisions of Chapter 5C

ASIC may deregister a scheme if:

- the scheme does not have a responsible entity that is a public company and that holds the required dealers licence: sec 601PB(1)(a)
- the scheme does not have a constitution that is legally enforceable between the responsible entity and the members, and that meets the prescribed content requirements: sec 601PB(1)(b)
- the scheme does not have a compliance plan that meets the prescribed content requirements: sec 601PB(1)(c) or
- the scheme property is not clearly identified as such and held separately in accordance with the compliance plan: sec 601PB(1)(d).

ASIC's ability to deregister a scheme in these circumstances is effectively an additional administrative sanction for non-compliance with the Chapter. If a scheme is deregistered, it may not be operated, although a person may take steps to wind up the scheme or remedy the defect that led to its deregistration.[9] Section 601PC allows for reinstatement of registration once the defect is remedied.

The procedure for deregistration

If ASIC decides to deregister a scheme under sec 601PB(1), it must give notice to the scheme's responsible entity, to any person winding up the scheme, on the national database and in the *Gazette*. Where the scheme is to be deregistered as a result of non-compliance, the notice must set out the time at which ASIC proposes to effect deregistration. Deregistration of defunct schemes and schemes that have been wound up can occur any

7. Section 601PB(1)(f).
8. Section 601PB(1)(e).
9. Section 601ED(5) and (6).

time after two months from the date of the *Gazette* notice. ASIC is required to give notice of the deregistration.[10]

Reinstatement

Under sec 601PC, ASIC may reinstate the registration of a scheme that has been deregistered if it is satisfied that the scheme should not have been deregistered, or that the defect that led to its deregistration under sec 601PB(1)(a)-(d) has been remedied.[11] The Court can order ASIC to reinstate the registration on application by a person aggrieved by the deregistration, or a person winding up the scheme, where the Court is satisfied that it is "just" to do so.[12] The Court may give any directions it thinks fit to put the scheme and others in the same position as if the deregistration had not occurred.[13]

If a scheme's registration is reinstated, ASIC must give notice in accordance with sec 601PC(4).

Winding up

Part 5C.9 deals with the winding up of registered schemes. Sections 601NA–601ND set out the circumstances in which a scheme may be wound up. Section 601NE requires the responsible entity to wind up the scheme in accordance with the constitution on the happening of the events specified in the section. Section 601NF deals with the power of the Court to make orders with respect to the winding up, and sec 601NG deals with unclaimed moneys on completion of the winding up.

Where the scheme is a trust, the statutory provisions will be supplemented by the general law on the termination of trusts.[14] Where the scheme is not a trust, the basis on which it is terminated will depend on the terms of the contract under which it was created.

Grounds for winding up

The circumstances in which a scheme must be wound up are set out in sec 601NE.

A scheme must be wound up if its constitution provides that the scheme is to be wound up at a specified time, in specified circumstances or on the happening of a specified event, and that time is reached, those circumstances occur or that event occurs.[15] Such provisions are expressly permitted under sec 601NA, and typically a scheme will be expressed to

10. Section 601PB(2)-(5).
11. Section 601PC(1).
12. Section 601PC(2).
13. Section 601PC(3).
14. See Grbich, Hutchins, Payes and de Wijn *Winding Up Trusts* (CCH 1984); Dal Pont and Chalmers *Equity and Trusts in Australia and New Zealand* (LBC 1996) 546–551.
15. Section 601NE(1)(a).

be for a fixed or ascertainable term, to avoid offending the rule against perpetuities.[16] Any provision of the constitution that purports to provide that the scheme is to be wound up if a particular company ceases to be the responsible entity is of no effect.[17]

If the members pass an extraordinary resolution directing the responsible entity to wind up the scheme, it must be wound up.[18] Winding up at the instigation of members is provided for in sec 601NB, which provides that members may take action under Division 1 of Part 2G.4 for the calling of a members' meeting to consider and vote on an extraordinary resolution directing the responsible entity to wind up the scheme. Nothing in sec 601NB would appear to preclude the responsible entity from initiating a members' resolution to wind up the scheme.

The Court may order the winding up of a scheme,[19] including on just and equitable grounds on the application of the responsible entity, a single director of the responsible entity, a member of the scheme, or ASIC.[20] In interpreting the "just and equitable" requirement, regard should be had to the case law on sec 461(1)(k) of the Corporations Law. In addition, the Court may order winding up on the application of a creditor where, within three months before the application was made, execution or other process was issued on a judgment, decree or order obtained in a court in favour of a creditor of, and against, the responsible entity in its capacity as the scheme's responsible entity and the execution or process was returned unsatisfied.[21]

Where the members pass an extraordinary resolution to remove the responsible entity and no replacement responsible entity is appointed, winding up is required.[22] Removal of the responsible entity is discussed in Chapter 4 above. The responsible entity that was the subject of the resolution is responsible for ensuring the scheme is wound up.

In addition, the responsible entity may elect to wind up the scheme where it considers that the purpose of the scheme has been, or cannot be, accomplished.[23] In these circumstances the responsible entity may chose to wind up the scheme, although it is not required to do so. The procedure required is set out in sec 601NC. The responsible entity must give notice to the members of its intention to wind up the scheme and, unless the required number of members requests a meeting in accordance with Division 1 of Part 2G.4 within 28 days of the notice, may proceed to winding up.

16. Although this may be unnecessary — see Ford and Hardingham 48, 52.
17. Section 601NA.
18. Section 601NE(1)(b).
19. Section 601NE
20. Section 601ND(1)(a) and (2).
21. Section 601ND(1)(b) and (3). The ground appears to reflect sec 459C(2)(b). On the position of the creditors generally, see Ford and Hardingham 71–82 and McPherson "The Insolvent Trading Trust" in Finn ed *Essays in Equity* (1985) 142. It is not clear in what circumstances it would assist the creditor to have the scheme wound up.
22. Section 601NE(1)(d).
23. Section 601NE(2).

The process of winding up

Under sec 601NE, the responsible entity of the scheme is required to "ensure that the scheme is wound up in accordance with its constitution and any orders under sec 601NF(2)".[24] However under sec 601NF(1) the Court may, by order, appoint a person to take responsibility for ensuring a registered scheme is wound up in accordance with these requirements 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)".

The Court has power to give directions about how a registered scheme is to be wound up if the Court "thinks it necessary to do so (including for the reason that the provisions in the scheme's constitution are inadequate or impracticable)".[25]

Application for an order that a person be appointed to wind up the scheme, or for directions in relation to the winding up, can be made by the responsible entity, a director of the responsible entity, a member of the scheme, or ASIC, under sec 601NF(3). The Court's powers under sec 601NF would not appear to expand to any degree its inherent jurisdiction to control the administration of trusts, where the scheme is a trust.

Where the scheme is a fixed trust, termination will usually occur by the distribution of the property of the scheme to the members in accordance with the constitution. The settlement of claims outstanding against the scheme assets is required of the responsible entity prior to distribution of the assets to the members. To fulfil this duty, the responsible entity may need to have regard to the *Trustee Act* in each jurisdiction, requiring a trustee to make the prescribed inquiries by way of published notice.[26]

Unclaimed moneys or assets held by the person winding up the scheme at the end of the winding up must be paid to ASIC to be dealt with under Part 9.7.[27]

Notification

Regulation 5C.9.01 requires the responsible entity to lodge a notice in the approved form telling ASIC that winding up of the scheme has commenced, or been completed, within 14 days of the commencement or completion.

24. Section 601NE(1).
25. Section 601NF(2).
26. See eg *Trustee Act 1925* (NSW) sec 60, *Trustee Act 1958* (Vic) sec 33.
27. Section 601NG.

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