

Growing Wealth

June 2009

STOP PRESS—Findings of the review of non-forestry schemes

Press release

On 29 May 2009, the Assistant Treasurer and Minister for Competition Policy and Consumer Affairs, Chris Bowen MP, released the findings of the review of non-forestry agricultural schemes.

The review examined the costs and benefits of such schemes, and assessed whether they are an effective tool for attracting investment to rural and regional Australia. The review was completed prior to Timbercorp and Great Southern going into administration.

Seventy-nine submissions were received in response to the issues paper released in August 2008.

Competing views

The review was intended to shed light on the debate about the benefits of agricultural schemes. There are two competing schools of thought. Some argue the growth in non-forestry schemes is due to concessional tax treatment, which distorts investment decisions and resource allocation, leading to overinvestment in certain industries and potentially causing commodity gluts. Others argue that because of non-forestry scheme's ability to attract funds, they can achieve world best practice and economies of scale that allow them to supply international markets more effectively and efficiently than a traditional farmer.

Findings

The findings of the review can be summarised as follows:

1. The tax treatment of investment in non-forestry schemes set out in Taxation Ruling TR 2000/8 *Investment schemes* is sub-optimal. However, this conclusion was reached using an economic substance approach (as opposed to looking at it from a pure legal and accounting perspective).
2. Managed investment schemes should be seen as a mechanism for attracting finance into agriculture and they are undoubtedly effective at this. There is some evidence this has facilitated the uptake of economies of scale, although this needs to be viewed against a broader trend towards farm consolidation. Further, the ability of managed investment schemes to attract finance cannot be divorced from the underlying tax treatment.

3. The effects of managed investment schemes on resource and commodity markets are less clear. In some cases, schemes purchase existing agricultural businesses and leave land use unchanged. However, a common theme of the review was that land use changed from low-value commodities to higher value ones. Hence, managed investment schemes appear to promote more efficient resource allocation by using the same land to produce higher value crops.
4. Managed investment schemes appear to promote more efficient water use, in some cases. Submissions provided several examples of schemes that had driven production into crops that used less water, or provided higher levels of profit per unit of water used. However, this may be related to the ability of schemes to raise finance on a large scale, which allows them to fund the implementation of efficient irrigation technologies, rather than relating to any inherent management advantage.
5. It is difficult to determine the impact of managed investment schemes on commodity markets and existing domestic producers. Some saw schemes as producing commodity gluts, while others considered that they allowed Australian producers to better compete in international markets. It seems that the effect of schemes depends on the characteristics of a particular commodity market and the perspective of the particular industry.
6. Given the differences in market characteristics and industry perspectives between different types of commodities, it is not possible to definitively conclude what impact managed investment schemes have on commodity markets and existing producers.

Comment

Chris Bowen made the following comments in his press release:

“There has been significant debate regarding the effect of non-forestry MIS on regional communities, including in relation to the tax treatment of these schemes. This report injects some evidence and analysis into this debate, and the Government will closely consider its findings. The Government will consider whether there is a need for changes to the tax treatment of non-forestry MIS in light of the recommendations of the Review of Australia’s Future Tax System.”

The paper is very interesting reading for anyone involved with agribusiness schemes, and is available at <http://www.treasury.gov.au>.



If you would like more information, then please contact **Langton Clarke** by email or on 07 3239 2926.

Litigation news

Did you know ...

Parts of the new *Fair Work Act 2009* (Cth) (the Act) come into force from 1 July 2009 with the balance to follow on 1 January 2010.

The Act will primarily affect corporate employers which may include corporate trustees. From 1 July 2009, restrictions on the rights of employees to make claims against their employer for statutory unfair dismissal will be relaxed and defences available to employers will be narrowed. Many employers who may have previously enjoyed protection from such claims will now be exposed.

Effective policies and procedures for termination of employment can go a long way to helping an employer defend unfair dismissal claims.

Contact

If you would like some advice as to how the Act will affect your business, or assistance in updating your procedures, then please contact Kristy Dorney, an associate in our litigation and risk management team.



Kristy Dorney can be contacted by email or on 07 3239 2968.

Government's response to corporate collapses

ASIC

Events such as the administration of two huge industry participants like Timbercorp and Great Southern always spark greater than average interest of the regulators.

The Australian Securities and Investments Commission has commenced writing to all agribusiness fund managers querying whether any changes will be made to offer documents in the market place in light of the corporate collapses. Understandably, the focus will include the following:

1. Disclosure of the financial position of responsible entities (and a holding company if relevant) plus the capacity to meet existing and future contractual obligations.
2. Reliability of statements about yield expectations and assumptions about when income will be produced. This will include analysing the adequacy of

risk disclosure about factors that may prevent any forecast income levels being achieved.

3. Whether a reduction in product sales is likely and how that may impact the responsible entity's financial position.

Parliamentary committee

On 27 May 2009, the Parliamentary Joint Committee on Corporations and Financial Services announced an inquiry into agribusiness schemes following the collapses which will focus on structure, marketing and taxation treatment. The timetable is as follows:

1. Submissions are due by the end of June 2009.
2. A public hearing will be held in mid July 2009.
3. The Committee will report to Parliament by 7 September 2009.

We will be making a submission to the inquiry and will attend and contribute to the public hearing.



If you would like more information, then please contact **Langton Clarke** by email or on 07 3239 2926.

Personal liability for scheme debts and insolvent trading

Competing duties

Directors of responsible entities have separate, and often competing, duties to the entities they manage. They are responsible for the management and solvency of the corporate entity that holds the AFS licence, and are accountable to shareholders for the way the funds management business is operating. However, they also have a separate, and higher, duty to the investors in each of the schemes for which they act. That duty requires them to ensure the schemes are being managed appropriately, and ultimately to ensure they are solvent.

Those competing duties, and the complexities inherent in managing a group of entities, can often obscure the need to make tough decisions in relation to a scheme's financial position. Those involved in the management of responsible entities need to be mindful of their personal exposure in relation to the scheme's debts.

Personal liability

In some circumstances, a responsible entity may incur personal liability for the debts it incurs on behalf of a scheme. This will occur when the scheme has insufficient assets from which to pay a debt, and—

1. the responsible entity has a contractual liability to pay the debt, or
2. the liquidator of the scheme finds the responsible entity has been guilty of insolvent trading.

There are steps available to a responsible entity to minimise the risk it will have to pay scheme debts from its own assets.

Contract

A responsible entity often enters contracts with other entities to supply goods and services to a scheme. When it does so, the responsible entity incurs a contractual liability to the supplier to pay for the goods and services. The responsible entity is personally responsible for payment of the account, and cannot resist a claim for payment simply because the scheme does not have sufficient resources to meet it.

The responsible entity can only avoid personal liability if the contract with the supplier specifically limits the supplier's rights to the assets of the scheme. If it is possible, then the responsible entity should negotiate with suppliers for a limitation on its liability to be included in the contract. This will not always be possible from a commercial perspective.

Insolvent trading provisions

The *Corporations Act 2001* (the Act) provides a director of a company has a duty to prevent the company from insolvent trading (section 588G). A contravention of that section by a director is an offence and exposes the director to the risk of being ordered to compensate the company.

Directors of responsible entities should take particular note of the following:

1. Responsible entities are subject to the insolvent trading provisions in relation to the solvency of managed investment schemes under their control.
2. There has not been any judicial consideration of the application of the insolvent trading provisions to a scheme. However, the insolvent trading provisions in the Act are designed to allow a liquidator to recover property or compensation for the benefit of the creditors of an entity on winding-up.
3. Managed investment schemes can be wound-up on the application of a creditor who, within the previous three months, had execution of a judgment against the responsible entity (in its capacity as the scheme's responsible entity) returned unsatisfied. Generally, the court will order the responsible entity to wind-up the scheme. However, the court has power to appoint a

liquidator to wind-up the scheme if the responsible entity is not properly discharging its duty. There might be grounds for the court to appoint a liquidator if there was an allegation that the responsible entity had allowed the scheme to incur debts whilst insolvent.

4. The Act defines a "corporation/scheme civil penalty provision" to include section 588G. If a declaration of contravention of section 588G is made, then ASIC may apply for a pecuniary penalty order or a disqualification order to be made against the directors of the responsible entity.
5. The Act also provides a court may order a person to compensate a company or a registered scheme for damage suffered as a result of the contravention of a civil penalty provision (including section 588G).

Indemnity

In most cases, the responsible entity has a right of indemnity from the scheme members for debts incurred on behalf of the scheme. However, a liquidator may seek an order from the court requiring the responsible entity to personally pay money to creditors in circumstances where the responsible entity has allowed the scheme to trade insolvently. It will then be a matter for the responsible entity to try to recover those payments from the members of the scheme. This may be difficult where the members are not financially capable of meeting the indemnity, or if they allege the responsible entity was responsible for the insolvency.

Elements of insolvent trading

There are three criteria to satisfy to prove a director has been guilty of insolvent trading. Those criteria also apply to a responsible entity, with appropriate modifications:

1. A person must have been a director of a company (or responsible entity of a managed investment scheme) when it incurred a debt.
2. The company (or managed investment scheme) was insolvent at that time, or became insolvent by incurring the debt. "Insolvent", for the purposes of the Act, means an entity is unable to pay its debts when they are due.
3. At that time, there were reasonable grounds for suspecting the company (or managed investment scheme) was insolvent, or would become insolvent, as a result of incurring the debt. A responsible entity will contravene this section if it is aware at the relevant time that there are grounds for suspecting the managed investment scheme is insolvent, or a reasonable person in the responsible entity's position would have that suspicion.

Defences

It is important to be aware of the defences available to a director/responsible entity because they give some guidance about the steps to take to avoid liability. There are a number of defences available under the Act as follows:

1. Reasonable grounds to suspect the managed investment scheme was solvent. It is a defence if it is proved, at the time the debt was incurred, the responsible entity had reasonable grounds to expect, and did expect, the scheme was solvent and it would remain solvent even if it incurred the relevant debt. The grounds on which the responsible entity forms the view as to the scheme's solvency must be reasonable, based on an objective consideration of all the circumstances.
2. Reliance on information from a reliable person. It is a defence if it is proved when the debt was incurred the responsible entity had reasonable grounds to believe and did believe each of the following:
 - (a) A competent and reliable person was responsible for providing it with adequate information about whether the scheme was solvent.
 - (b) The other person was fulfilling that responsibility.
 - (c) The responsible entity accepted, on the basis of information provided to it by the other person, that the scheme was solvent at that time and would remain solvent even if it incurred the debt.

The belief of the responsible entity must be based on reasonable grounds, that is, whether a reasonable responsible entity having regard to all of the circumstances would have formed the same view.

3. Reasonable steps were taken to prevent the managed investment scheme from incurring the debt. The reasonableness of the action is to be judged objectively, that is, what steps would a reasonable responsible entity in its position have taken. The court will consider any action the responsible entity could have taken including the appointment of a provisional liquidator.

Action

Directors of responsible entities should do the following to protect their position:

1. If possible, then negotiate with suppliers to excuse the responsible entity from personal liability for debts and to limit the supplier's right to recover to the assets of the scheme.
2. Make sure you keep up to date with the scheme's financial affairs and actively scrutinise reports given to you. Be aware of any potential solvency issues that are brewing.
3. Make sure the people to whom you delegate are competent, and undertake regular reviews of their work.
4. Be active, not passive. Take steps to ensure the scheme is being conducted in an appropriate way, including seeking legal or accounting advice if appropriate.

5. In some circumstances, the directors of the responsible entity will have no choice but to move to urgently wind up the scheme to prevent it (and the responsible entity) from trading insolvently.



If you would like more information, then please contact **Sarah Davies** by email or on 07 3239 2960.

Changing a constitution without a meeting—Court considers power of responsible entities

Introduction

The *Corporations Act 2001* (Act) allows a responsible entity to amend a project's constitution without an investor meeting, if the responsible entity reasonably considers the amendment will not adversely affect investors' rights.

A recent single judge decision of the New South Wales Supreme Court has provided some very helpful guidance on the scope of the power and the processes a responsible entity should go through in deciding whether or not an amendment must be put to investors. The judgement in *ING Funds Management Limited v ANZ Nominees Limited; ING Funds Management Limited v Professional Associations Superannuation Limited* was handed down in early April.

Relevant facts

The circumstances of the case are quite topical, the current global financial crisis obviously having played a role in the events which unfolded.

The Court was asked to consider decisions made by ING Funds Management Limited (ING) as responsible entity for two cash funds. ING decided to take steps to effectively suspend redemptions, to protect the funds and investors from the possible impact of large levels of redemption requests. ING purported to amend the funds' constitutions (without investor approval), to suspend the processing of redemption requests until investor meetings were later held.

The Court's decision

Among other things, the Court decided there was no reasonable basis for ING reaching the conclusion that the changes would not adversely affect investors' rights. ING's board did not conduct a proper analysis of whether the rights of the investors would be adversely affected by the proposed changes. Rather, the decision to make the changes was in reality justified on the basis it was in investors' best interests to temporarily suspend redemptions, given financial and market conditions.

The Court found the changes did adversely affect investors' rights—investors' rights were altered by denying their previous right to have redemption requests processed.

What can be learned from the decision?

Careful analysis is always required

The test under the Act is whether the responsible entity "*reasonably considers*" a proposed change will not adversely affect investors' rights.

The Court stated (quite unequivocally) that ING failed this test. The reason for this was all the evidence showed that the board did not go through a detailed process of determining what rights investors had before the amendments, and then whether those rights would be adversely affected after the changes.

The key point (and arguably the most important one to come out of the case) is that a responsible entity must actually go through a careful and deliberate process of analysing what investors' rights are, and then whether those rights will be adversely affected. This process, and the reasons for the conclusions the responsible entity arrives at, must be documented, in detail.

The case demonstrates it is not enough for a fund manager to determine that the proposed changes are, for example, "in investors' best interests" or "necessary to protect investors' interests"—this will not be sufficient.

Difference between investors' "rights" and "interests"

There has been uncertainty, arising from comments in some previous cases, about exactly what investors' "rights" are in the context of the relevant section; and therefore, when investors' "rights" will be adversely impacted.

There has been a view that any change which might have an adverse impact on investors' "interests"—for example, the *value* of their units—may be one requiring investor approval under the Act.

However, the Court did not take this view. It said the distinction between the rights of investors and the interests of investors is quite clear. Therefore, the responsible entity must examine whether investors' rights, as created by the constitution—as distinct from investors' enjoyment of them, or their value—will be changed or impinged by the modification.

Conclusion

If you are considering making changes to your project's constitution (without an investor meeting), then it is very important to ensure you—

1. carefully consider what the current rights of investors are under the constitution

2. carefully and objectively consider, in detail, whether any of those rights will be adversely affected by the changes (it is not enough to simply decide the changes are necessary to, say, protect investors' interests)
3. document, in detail, and at board level, all of your reasoning and conclusions, and
4. remember your duty to always act in the best interests of investors—this is separate from the question of whether a change will adversely affect investors' rights, but just as important.

McMahon Clarke Legal can assist you in the decision process, prepare the necessary amending deed and ensure the constitutional changes are effected.



If you would like more information, then please contact **Matthew Moses** by email or on 07 3239 2928.

Changing responsible entity in times of crisis

Administration

A change in the responsible entity of a registered scheme usually results either because the responsible entity wishes to retire or the scheme members wish to vote the responsible entity out. However, where a responsible entity is experiencing significant financial distress and an administrator is appointed, it will become a matter for the administrator to determine whether it is in the best interests of scheme members to continue to operate the scheme by appointing a new responsible entity or whether winding the scheme up (with a fire sale of the scheme's assets) is more appropriate.

Handover

Chapter 5C of the *Corporations Act 2001* (Act) sets out the regime for the facilitation of a change of responsible entity. In particular, sections of the Act aim at placing the new responsible entity in the former responsible entity's shoes with respect to the scheme.

Once a change in responsible entity has taken effect, the Act provides the former responsible entity's 'rights, obligations and liabilities' in relation to the scheme become the rights, obligations and liabilities of the new responsible entity.

Further, the Act seeks to prevent the need for novation or assignment of documents from the former responsible entity to the new responsible entity and aims to preserve the effect of any other documents in existence. The Act does this by providing that—

1. all documents to which the former responsible entity was a party have effect as if the new responsible entity (and not the former responsible entity) was a party to it , and
2. all documents under which the former responsible entity has acquired or incurred a right, obligation or liability have effect as if the new responsible entity (and not the former responsible entity) has acquired or incurred the right, obligation or liability under it.

Review of documents

The intended result of these provisions is that all rights, obligations and liabilities in relation to the scheme and any documents become novated to the new responsible entity.

However, as the provisions are limited to documents which are ‘capable of having effect after the change’, they expressly contemplate documents entered into by a former responsible entity being drafted in a form which have the effect that the document ceases to be operative upon a change in the responsible entity. Accordingly, upon the change of a responsible entity, the relevant documents will need to be carefully reviewed in each instance to determine whether they contain any provisions which impair the ‘seamless’ transition intended by the Act.

Temporary responsible entity

The Act also facilitates the court appointment of a temporary responsible entity. It provides that the Australian Securities and Investments Commission (ASIC) or a scheme member may apply for the appointment of a temporary responsible entity to a scheme if the scheme’s responsible entity no longer meets certain requirements (namely, the responsible entity is a public company that holds an Australian financial services (AFS) licence authorising it to operate the scheme). This can be of limited use in reality. In the case of the Timbercorp and Great Southern responsible entities, for example, ASIC has not yet suspended or revoked either AFS licence and so the right to apply to the court has not crystallised.

However, a specific regulation to the Act provides that ASIC or a member may apply for the appointment of a temporary responsible entity if ASIC or the member reasonably believes the appointment is necessary to protect scheme property or the interests of members.

The difficulty with the relevant sections of the Act is they require either ASIC or a member to take the first step, which may cause problems for the continued operation of the scheme if neither is willing to do so.

Impact

Generally it will be the case though, should all things remain equal, where a change of responsible entity occurs either as a result of the decision of an administrator or otherwise, then it will be business as usual for the scheme.

In the current economic environment, it will also generally be the case that keeping the scheme operating will maintain most value for members as a fire sale of assets is unlikely to generate acceptable returns. In this case, the Act operates to facilitate the change of responsible entity and reduce the impact on members that any change in responsible entity will have.



If you would like more information, then please contact **John Lane-Mullins** by email or on 07 3239 2960.

The Carbon Pollution Reduction Scheme—What will it mean for agricultural and forestry companies?

CPRS

With the recent introduction of the Bills into parliament which will create the Commonwealth Government's much maligned Carbon Pollution Reduction Scheme (CPRS), agricultural and forestry companies will need to begin preparing to operate in a carbon constrained environment.

This article provides a high level summary of the structure of the CPRS and its potential impact on agricultural and forestry companies.

Key features of the CPRS

The key features of the CPRS are as follows:

1. The CPRS is a "cap and trade" system, which means that the government sets an annual "cap" on the level of carbon emissions from all of the participants covered by the CPRS. CPRS participants must then surrender tradeable carbon pollution permits known as Australian Emissions Units (AEUs) for each tonne of carbon dioxide equivalent to their emissions for that particular year.
2. The government has indicated that it will include an 'unconditional' commitment to a 5 percent reduction in greenhouse gas emissions (below 2000 levels), moving towards a 15 percent reduction with greater cooperation at the global level and a 25 percent national reduction target if a comprehensive global agreement is achieved.

3. The CPRS will cover approximately 1000 companies and 75 percent of Australia's total emissions.
4. Deforestation in the forestry sector will be excluded, although offset credits created through afforestation activities will be included on a voluntary basis.
5. Agriculture will have a delayed entry into the CPRS, to be included by no later than 2015 with a final decision made in 2013.

Possible impacts of the CPRS on the agricultural industry

As noted above, companies in the agricultural industry have a delayed start to the CPRS. This will mean that until a decision is made on agriculture's entry into the CPRS (expected by no later than 2013) the large majority of agricultural companies are unlikely to have direct obligations under the CPRS. The Australian Bureau of Agricultural and Resource Economics (ABARE) has undertaken research which shows the current threshold proposed in the CPRS will only capture the largest beef farms in the Northern Territory. However, agricultural companies will still be indirectly affected through increased costs of production.

The main cost increases agricultural companies potentially face are increases in electricity, fuel, freight and chemicals and fertilisers. Initially (from 1 July 2011 to 30 June 2014) agricultural companies should be shielded from some of the effects of the increases in fuel by CPRS fuel credits which will be provided by the government to agricultural companies. However, after that assistance is withdrawn, the costs of fuel, and therefore the costs of production, will increase.

The government has assumed the CPRS fuel credits will fully shield agricultural companies from increases in the prices of fuel used on the farm and that because of the assistance provided to Emissions Intensive Trade Exposed entities, the cost of freight, chemicals and fertilisers will not increase in the initial years of the CPRS.

If the government's assumptions are correct, then the main increase in the cost of production faced by agricultural companies will be increases in electricity. ABARE has undertaken research based on these assumptions which indicates the initial increases in costs of production will be marginal (ranging from 0.1 percent for beef producers to 0.5 per cent for dairy farmers).

However, interestingly that same report predicts that if agriculture is included in the CPRS in 2015, then the costs of production will increase between 2.5 and 3.8 percent depending on the industry.

Possible impacts on the forestry industry

Forestry companies are also unlikely to be caught by the CPRS. Like agricultural companies, forestry companies will primarily face increases in the cost of electricity. However, unlike agricultural companies, forestry companies are not entitled to apply for CPRS fuel credits. This will mean these companies may face increases in the costs of harvesting.

The other main difference between forestry companies and agricultural companies is that forestry companies have an opportunity to 'opt in' to the CPRS to receive free AEU's (which can then be on-sold) if they engage in reforestation activities which satisfy stringent conditions set out in the CPRS. Presently, we find it difficult to see how forestry companies which engage in plantation activities (and in particular single rotation forestry plantations) would be able to benefit from 'opting in' to the CPRS. However, this is an issue we are following closely and will provide regular updates on as the area develops.

Conclusion

As can be seen from the measures set out above, the CPRS could have a significant impact (especially in the long term) on the way agricultural and forestry companies operate and the investments decisions they make.

We will continue to closely monitor this area and will report on any further developments.



If you would like more information, then please contact **Brendan Ivers** by email or on 07 3239 2957.

Managed investment scheme registration—online applications

ASIC has made their scheme registration process faster and more efficient by allowing applications for registration of managed investments schemes to be lodged electronically by Australian financial services licensees and ASIC registered agents.

If the lodging entity has not previously used ASIC's online portal, then it will first need to register for access. Once registered, applications for scheme registrations may be carried out online, by uploading signed, scanned copies of the constitution, compliance plan and ASIC forms.

The requirements for registering a managed investment scheme have not changed. For example, copies of the constitution, compliance plan and the required ASIC forms must be signed in accordance with the *Corporations Act 2001* as previously. However, when an application is lodged online, the original copies are not required by ASIC, although the responsible entity must retain them for seven years.

Upon lodgement, the online system generates an invoice for the lodging entity to arrange payment to ASIC. The lodgement fee of \$2,010 has not changed.

Applications may also continue to be made by lodging paper copies.

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McMahon Clarke Legal
62 Charlotte Street Brisbane Q 4000
GPO Box 1279 Brisbane Q 4001
T 07 3831 8999 F 07 3831 1121