

Growing Wealth

February 2010

Proposed new MIS disclosure regulations

Draft regulations

In December 2009, the Federal Government released the draft regulations for the new managed investment scheme disclosure regime. The consultation period is almost over but the main point is the regulations, as currently drafted, will not apply to agribusiness schemes.

The commentary to the regulations indicates the consultation process will clarify which types of schemes will be included or excluded, although the intention is only to cover basic or “vanilla” schemes. This is because the regulations will only apply to product disclosure statements for schemes which invest at least 80 percent of their assets in “financial assets”. Whilst the term “financial assets” is not defined in the *Corporations Act 2001*, it is defined in the Australian Securities and Investments Commission’s (ASIC) pro forma 209 setting out standard Australian financial services licensing conditions and if that definition is used, then agribusiness schemes will not be caught.

This is an excellent (and commonsense) outcome. We have been lobbying the government through the involvement of one of our partners (Andrew Shearer-Smith) on the government’s Industry and Consumer Advisory Panel. Thankfully, it seems the message has got through that it would be unfavourable for a supposedly simpler disclosure regime to be imposed on a sector which is complex by its nature and simply requires enhanced disclosure to properly promote investment products.

Further disclosure on the way

However, it is not all plain sailing. The agribusiness investment sector needs to expect ASIC to move on greater disclosure in light of the large corporate collapses last year. At ASIC’s recent Financial Services Consultative Committee meeting which we are invited to attend, ASIC provided the following update on its regulation of agribusiness schemes:

1. It intends to consult the industry in relation to issuing a regulatory response in light of the recent collapses.
2. ASIC acknowledges appointing a temporary responsible entity to an agribusiness scheme is not easy, particularly given the new responsible entity generally inherits the burdens and liabilities of the old responsible entity.

3. Crucially, a new disclosure regime for agribusiness schemes will be implemented at some stage. ASIC is considering whether to go down the path adopted for unlisted property funds and mortgage schemes which require additional disclosure on specific items. All indications are ASIC is likely to adopt that approach.

We will keep you advised in upcoming editions of *Growing Wealth* on ASIC's approach.



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

What is the date of change of a responsible entity?

Recent case

In a recent case, the Federal Court had to consider the precise date of change of responsible entity (RE) when an RE was removed and replaced with another RE pursuant to a resolution of members of the scheme. Section 601FJ of the *Corporations Act 2001* (the Act) provides as follows:

... the company named in ASIC's record of registration as the responsible entity or temporary responsible entity of a registered scheme remains the scheme's responsible entity until the record is altered to name another company as the scheme's responsible entity or temporary responsible entity.

In the case before the court, the RE had been removed by resolution of members on a certain date and then the form 5107 notifying ASIC of the resolution of members was lodged at a later date. Subsequent to this, ASIC processed the form 5107 and changed the name of the responsible entity in ASIC's records to the new responsible entity. As such, there were three competing dates that could be argued to be the date of change of the RE.

The court found the relevant date for the purposes of the Act was the date on which ASIC effected the change by changing the name next to "responsible entity" on the ASIC register.

Consequences

The importance of identifying the precise date on which a change of RE is effected can be explained by reference to section 601FS of the Act, which provides that the rights, obligations and liabilities of a former RE in relation to the scheme become the rights and obligations of the new RE. Both the incoming and outgoing REs need to be aware of the date on which the former RE is relieved of its duties and the new RE takes up those duties.

It would be easy for the former RE to cease conducting its role as soon as it becomes aware of the passing of a resolution to replace it. However, if ASIC takes some days or even weeks to process the form notifying it of the change, then the former RE is potentially exposed to liability for abandoning its duties early on the assumption that the new RE is obliged to take over immediately.



If you would like more information, then please contact **Nathan Shaw** by email or on 07 3239 2947.

AUSTRAC surveillance—focus on AML/CTF independent reviews

Compliance assessments

In May 2009, McMahon Clarke Legal issued an AML/CTF e-bulletin, the purpose of which was to highlight the requirement under the *Anti-Money Laundering and Counter-Terrorism Financing Act 2006* (the Act) for reporting entities to undertake regular independent reviews of ‘Part A’ of their AML/CTF programs.

At that time, we noted the Australian Transaction Reports and Analysis Centre (AUSTRAC) was likely to begin increasing its level of compliance assessments of reporting entities as part of its regular monitoring program.

This forecast has now come to fruition!

Towards the end of 2009, it appears AUSTRAC determined to enhance its AML/CTF assessment activity and many reporting entities will have already been subject to an AUSTRAC compliance assessment of their AML/CTF program. AUSTRAC says the objective of these assessments is to evaluate the policies, programs and processes which the reporting entity has implemented to meet its obligations under the Act.

Mandatory independent reviews

In our experience, a recurring finding of the AUSTRAC assessments to date is the failure of the reporting entities to have undertaken an independent review of ‘Part A’ of their AML/CTF programs. Given there is no prescribed timing under the legislation within which reviews must occur, only that they be undertaken “regularly”, this finding is perhaps not surprising. However, the results of AUSTRAC’s surveillance are a timely reminder to those reporting entities who have yet to arrange a ‘Part A’ independent review that AUSTRAC is closely monitoring compliance with this obligation.

With respect to conducting an independent review, reporting entities must determine whether the review can be conducted by an internal unit or whether an external independent reviewer is more appropriate. It is important the reporting entity is able to demonstrate the independence and quality of the review process. Accordingly, an external reviewer will generally need to be engaged unless the reporting entity is able to employ the services of an internal auditing section (or another 'independent' area).

McMahon Clarke Legal can assist reporting entities meet their legislative requirements by conducting an independent 'Part A' review.

For more information regarding the independent review process or to discuss the independent review of 'Part A' of your AML/CTF program, please contact us.



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



If you would like more information, then please contact **John Lane-Mullins** by email or on 07 3239 2926.

Litigation news

Insolvent trading

The *Corporations Act 2001* (the Act) imposes heavy penalties on directors who fail to prevent a company from trading whilst insolvent.

A director will breach his or her duty to avoid insolvent trading where—

1. the company incurs a debt and the company is insolvent at the time of incurring the debt or becomes insolvent as a result of incurring the debt, and
2. the director had reasonable grounds for suspecting or did in fact suspect that the company was insolvent, or would become insolvent.

Test for solvency

A company is insolvent when it cannot pay its debts as and when they become due and payable. This is not simply ascertained by looking at the bank account of the company but from considering the financial position of the company as a whole.

The company's financial position includes—

1. the ability of the company to borrow on the security of its assets
2. the willingness of its secured creditors to lend the company money despite its financial difficulties
3. the company's present unsecured borrowings and the possibility of further unsecured borrowings, and
4. any loans taken by related corporations and loans from directors of the company.

Conclusion

Where a company is wound up in insolvency, the Australian Securities and Investments Commission, the liquidator of the company or a creditor of the company may commence proceedings against the directors to recover loss or damage incurred as a result of the directors' contravention of the Act. Civil penalties of up to \$200,000 may also be imposed on the directors. Alternatively, directors may be subject to criminal charges which can result in a fine of up to \$220,000 or five years' imprisonment where there is a finding that the directors have acted dishonestly.

It is imperative that directors seek the advice of their accountants and legal advisors where it is suspected that a company of which they are a director may be insolvent. If no other remedial action is possible, then the directors might be well advised to appoint an administrator to the company to avoid further debts being incurred and to prevent personal liability attaching to them.



If you would like more information, then please contact **Allana Agnew** by email or on 07 3239 2947.

Proposed new proper purpose test for access to company registers

Unsolicited offers

The Minister for Financial Services, Superannuation and Corporate Law has released a proposals paper titled 'Access to company registers and related issues'.

The Federal government appears motivated to stamp out unsolicited "*undervalued, often predatory*", off-market share offers to unsuspecting and vulnerable shareholders. A survey by the Australian Securities and Investments Commission (ASIC) showed that most of the shareholders who took up undervalued offers were unaware that they were significantly below market value.

The government canvassed legislative solutions in an options paper in May 2009 and released the first proposals paper in February 2010, announcing “*moves to stop preying on shareholders and reduce business costs*”.

Access to company and scheme registers

There is currently no proper purpose test for **access** to information on company and scheme registers, only for **use** of the information obtained. Companies must allow anyone to inspect or copy their member registers and cannot refuse access if they reasonably believe the information will be misused in breach of the *Corporations Act 2001* (the Act). It has been criticised as the proverbial ‘horse has bolted’ provision.

The proposals seek to restrict improper use of register information while maintaining transparency and availability of the information for legitimate purposes, and to update current provisions to reflect developments in technology (such as computerised records of registers).

The proposals paper has not taken up the previously suggested options of a cooling-off period, requiring offers to include a prominent warning, giving a pre-emptive right to companies to intervene in sales or establishing a ‘Do Not Contact’ register.

Proper purpose test

It is instead proposed to include a ‘proper purpose’ test at the request stage. A party applying to a company for access to its share register would have to first satisfy the company that it intends to use the information for a proper purpose. If the company decides the stated purpose is improper, then the applicant has 20 days to apply to a court for review of the company’s decision.

There would be no definition of the term ‘proper purpose’ in the Act. Instead, ASIC would publish guidance on what constitutes a proper purpose and the *Corporations Regulations* will contain a non-exhaustive list of improper purposes. Improper uses would include—

1. solicitation of donations from shareholders by specific groups in the community, such as charities
2. solicitation of clients by brokers
3. gathering of information regarding the personal wealth of shareholders, and
4. the making of off-market offers to purchase securities in a listed company other than for a takeover.

New offences for the misuse of information are proposed. Knowingly or recklessly making a statement (regarding purpose) that is misleading, false or deceptive would be an offence, as would doing anything that may result in register information being disclosed to another person if the first person suspects that person may use the information for an improper purpose.

Fees

A proposed three-tier fee structure would replace the ‘reasonable amount that does not exceed the marginal cost’ which companies are currently permitted to charge. That fee was effectively capped at \$250 in 2009 by the Federal Court in *Direct Share Purchasing Corporation Pty Ltd v AXA New Asia Pacific Holdings Ltd*.

The proposed three tiers correspond to companies or schemes with up to 5,000 members (flat fee of \$250), between 5,000 and 20,000 members (\$250 plus 5 cents for each member in excess of 5,000) and more than 20,000 members (\$1,000 plus 1 cent for each member in excess of 20,000).

Format

The existing reference to ‘floppy disks’ would be removed and a regulation-making power introduced into the Act to prescribe electronic formats and storage devices currently supported in the business community.

Currently, a party can demand a hard copy of a register even if it is held on computer. Proposed amendments allow a register to be viewed on computer if adequate security measures are in place protecting the information of members.

Impact of proposed reforms

The proposed proper purpose test would not impact shareholders seeking access to the register to exercise their rights as shareholders. All shareholders would benefit from the increased protection of the personal information on the registers and vulnerable investors would be protected from below-value off-market offers. The reforms will probably reduce the number of requests and give companies the capacity to require electronic inspection and to control costs.

The proper purpose test would disadvantage shareholders who prefer to rely on unsolicited offers as a way of easily selling their shares, and applicants, who would have the additional burden of providing written reasons for their application.

We will keep you advised about the progress of these proposed reforms.



If you would like more information, then please contact **Amanda Shaw** by email or on 07 3239 2968.

One.Tel case—important update on directors’ duties

ASIC fails to prove its case

Justice Austin in the New South Wales Supreme Court handed down judgement on 18 November 2009 in the case brought by the Australian Securities and Investments Commission (ASIC) against Jodee Rich and Mark Silbermann. The action was commenced in December 2001, shortly after the collapse of One.Tel. ASIC’s case was that Mr Rich and Mr Silbermann misled the One.Tel board (which included James Packer and Lachlan Murdoch) about the financial state of the company.

Whilst One.Tel was a listed entity, its major shareholders were Kerry Packer’s Publishing & Broadcasting Limited and Rupert Murdoch’s News Corporation. Both of those entities lost huge sums in the One.Tel collapse. The question which Justice Austin had to determine was whether or not the executive directors had failed to keep the board informed of the company’s financial position. He did not have to determine whether or not the other directors on the board were careless in failing to find out the truth about their company’s position, although that issue might arise in other litigation currently on foot.

Waste of time?

Some commentators have pointed out that the case is a lesson for ASIC in how not to run litigation. The case ran for eight years and is reported to have cost ASIC \$20 million in legal fees. If ASIC is ordered to pay the costs of the defendants, then the case could cost ASIC up to \$40 million in total. This is particularly significant when considered in light of ASIC’s overall annual budget of about \$300 million. There is no doubt that the case has chewed up an enormous amount of resources and diverted attention away from other routine compliance and enforcement activities.

However, the case will be of great interest to anyone involved in the management of companies. Justice Austin is an acknowledged authority on directors’ duties, and he has written his judgement in a way which will be of assistance to a wide audience outside of the One.Tel mishap. The judgement is 3,105 pages long but is conveniently broken up into chapters. Anyone wanting to focus on the important findings regarding directors’ duties should read chapter 23 which starts at page 2,942.

We have summarised some of the findings from the case, but for a more comprehensive coverage of the case, please go to our full length article [here](#).

Directors should take note that this represents the current state of the law in Australia and their performance will be judged against these principles.

Duty of care and diligence

1. Justice Austin noted that the *Corporations Act 2001* (the Act) did not intend to dampen business enterprise and penalise legitimate but unsuccessful entrepreneurial activities. Accordingly, the question whether a director had exercised a reasonable degree of care and diligence for the purposes of the Act could only be answered by balancing the foreseeable risk of harm against the potential benefits that could reasonably have been expected to accrue to the company from the conduct in question.
2. In assessing what a reasonable person would do in the position of the director in response to a given risk, the court needs to consider the magnitude of the risk and the degree of the probability of its occurrence, along with the expense, difficulty and inconvenience of taking alleviating action and any other conflicting responsibilities the director may have. In considering the cost of alleviating action, Justice Austin accepted a submission put to him by Mr Rich and Mr Silbermann that the court should avoid a finding that certain information not contained in board papers should have been there where the consequences may be that board papers would grow to the size of a telephone book.
3. The statutory standard of care and diligence for company directors recognises the distinction between negligence and mere mistakes. In particular in the *One.Tel* case, the complaints made by ASIC were about financial forecasting. Justice Austin noted that forecasting is a difficult and uncertain process, with much room for mistakes and errors of judgement, and for differences of opinion. The directors could not be liable just because they made mistakes in the processing of financial forecasting or because they formed a different opinion to ASIC or the court.

Business judgement rule

1. In considering what constitutes a business judgement, Justice Austin approved U.S. commentary to the effect that it doesn't just encompass risky or economic decisions, but also applies to decisions relating to corporate personnel, the termination of litigation and other less explicit business decisions. It could embrace decisions including the setting of policy goals and the apportionment of responsibilities between the board and senior management. Justice Austin also considered that it would include matters of planning, budgeting and forecasting.
2. However, he noted that under the Act, it must involve "*a decision to take or not take action*". This means that a decision must consciously be made so that the judgement has actually been exercised. A director who simply neglected to deal with proper safeguards, with no evidence that he or she even turned his or her mind to a judgement of what safeguards there should be, has not made a business judgement and accordingly, cannot invoke the defence.

3. In *One.Tel*, ASIC claimed that Mr Rich and Mr Silbermann had artificially attempted to treat what was, in substance, inaction or omissions on their part as conscious and considered acts involving the exercise of judgement. Justice Austin did not accept that submission. He accepted evidence from Mr Rich and Mr Silbermann that they made decisions about the matters of which ASIC complained. It was not a case where the directors had failed to turn their minds to decisions that ASIC alleges they should have taken. The directors considered the matters of which ASIC complained, but made decisions with which ASIC disagreed. In essence, this is why ASIC's action failed.

Conclusion

The reasoning and conclusions in this case are compelling reading for anyone involved in the management of a company. Justice Austin has articulated the principles relevant to assessing the performance of a director in a way that should be readily understandable to company directors and officers.

McMahon Clarke Legal can assist you with any queries regarding directors' liability and obligations.



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

Update on statutory novation on change of responsible entity

Judgement

In the [November 2009 issue](#) of *Growing Wealth*, we explained the basic operation of the novation provisions in the *Corporations Act 2001* (the Act), which govern the rights, obligations and liabilities in relation to a registered scheme upon change of the responsible entity. Judgement has now been delivered in the two cases referred to in that article. The decisions provide useful insight into how the novation provisions apply in the context of agricultural schemes.

Management fees

The first case concerned the rights of competing responsible entities to management fees relating to the year in which the change of responsible entity took place. It related to five schemes that were structured as typical agricultural schemes. The responsible entity was compensated for its services by the payment of a lump sum annual management fee. In relation to each of the schemes, the responsible entity was replaced at a meeting of members held during the year and, in most cases, after the obligation to pay fees to the responsible entity arose.

The incoming responsible entity claimed it was entitled to a pro rata proportion of the fees for the year. The former responsible entity argued that, on the construction of each of the management agreements, the fees were an indivisible sum the right to which arose prior to the change of responsible entity and, as such, the former responsible entity was entitled to retain the full amount. The new responsible entity responded that this would lead to an absurd result as, for example, if the responsible entity was replaced on the second day of the year and the fees were due on the first day of the year, the incoming responsible entity would have no fees with which to perform its obligations as responsible entity.

The court rejected the new responsible entity's arguments and found the management fees were not apportionable on a pro rata basis and that the former responsible entity was entitled to retain the fees that it had collected prior to the change of responsible entity. The court noted that it was incumbent on members and the incoming responsible entity to consider matters such as funding the responsible entity's duties prior to moving to appoint a new responsible entity.

The court specifically said that none of the findings in the judgement would affect any right that the members of the schemes had against either responsible entity. As such, if a member were to seek a refund of fees from either of the responsible entities, it would be a separate question that would need to be tried in a separate proceeding.

Supply agreement

The second case concerned whether an owner of a water resource who had contracted with the former responsible entity for the supply of water to the scheme could enforce the provisions of that contract against the new responsible entity.

A water supply contract was entered into early in the life of several agricultural schemes and provided for the provision of water from a lagoon located on land owned by the water owner to the responsible entity to allow it to irrigate the land which was the subject of the schemes. Some years later, the responsible entity was replaced by a new responsible entity, who claimed the water supply agreement was not binding on it. The water owner claimed the water supply contract was binding on the new responsible entity and it was liable to pay the fees owing under that agreement pursuant to the statutory novation provisions, as the obligations under the contract were a right, obligation or liability of the former responsible entity in relation to the scheme.

The court closely analysed the provisions of the water supply contract, particularly those that specifically provided for what happened if the responsible entity retired, was replaced or was removed. The court held the water supply contract operated such that there was no continuing liability to the water owner after a change of responsible entity.

Conclusions

The most important conclusion to be drawn from these two cases is that the question of whether a right, obligation or liability in relation to a scheme will carry across to the new responsible entity needs to be considered in light of the scheme documents. In the management fee matter, one of the critical factors was the nature of members' obligation to pay fees as provided for in the management agreements. In the case of the water supply matter, the most important question was the operation of the water supply contract.

Incoming responsible entities, outgoing responsible entities and third party contractors need to be aware of the operation of these provisions when there is a prospect of a change in responsible entity. Also, when drafting and entering into such documents or contracts early in the life of the scheme, the potential for a change of responsible entity needs to be considered and documents drafted accordingly.

Appeals

Both of these decisions are presently under pending appeals and we will keep you posted with the results of the appeals.

McMahon Clarke Legal has expertise in drafting scheme documents and dealing with any disputes that arise.



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

Employment law news

Did you know ...

From 1 January 2010, the balance of the new *Fair Work Act 2009* (Cth) (the Act) came into force. The bulk of the Act came into force on 1 July 2009. However, introduction of the expanded list of minimum statutory employment conditions, known as the National Employment Standards, and modernisation of the award system was deferred until 1 January 2010.

Also from 1 January 2010, the Queensland and New South Wales Parliaments' referral of their powers to the federal government, relating to industrial relations for the private sector, took effect with the result that sole trader and partnership employers in those States will now be governed by the Act.

Previously, the federal government's power to legislate was limited to national system employers (largely companies incorporated under the *Corporations Act 2001* and all employers in the Northern Territory and the Australian Capital Territory) which meant that important provisions of the Act would not apply to most private sector employers such as sole traders and partnerships.

All States except Western Australia (who has refused) have now passed legislation referring their powers to the federal government.

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.



If you would like more information, then please contact **Kristy Dorney** by email or on 07 3239 2968.

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