

## Growing Wealth September 2009

### Disclosure moving forward

#### Collapses

In the last edition of Growing Wealth we reported on ASIC's response to the collapses of the agribusiness giants, Timbercorp and Great Southern (click [here](#) to read the article). Most, if not all, agribusiness scheme promoters subsequently received correspondence from ASIC querying whether any changes would be made to offer documents in the market place at the time in light of the collapses.

#### ASIC's focus

It transpired ASIC pushed for—and got—additional disclosure by way of supplementary offer documents. ASIC's focus was in these areas:

1. The financial position of the responsible entity and its capacity to meet existing and future obligations under contracts with growers.

In particular, ASIC's concerns were offer documents gave insufficient detail and prominence to the manner in which responsible entities ensured they had sufficient amounts of working capital to cultivate and maintain a project over its life. ASIC specifically queried whether responsible entities quarantined specific funds into a designated account to ensure they could only be used for a particular scheme.

2. Reliability of statements relating to yield expectations and timing plus assumptions about when income will be produced.
3. Whether a reduction in product sales was likely and how that may impact each responsible entity's financial position.

In particular, ASIC's specific concern was offer documents needed more disclosure about the reliance on annual scheme sales as a revenue source for working capital.

Perhaps unsurprisingly, most industry participants took the path of least resistance and issued a supplementary PDS. Moving forward, product issuers need to expect that ASIC will closely scrutinise disclosure of these and related matters.

## Broader issues

ASIC's requirements do give rise to some broader issues about product disclosure and scheme structures including the following:

1. Whether initial funds subscribed by growers should remain quarantined in a project account, even though management agreements with growers would generally enable those funds to be applied by the responsible entity in accordance with the agreements' terms—that is, the amount is paid in advance to the responsible entity who can then use and apply those funds as its own assets as it sees fit. We would be concerned that quarantining those funds would be a retrograde step and take us back to structures akin to those in the pre-managed investments era.
2. Whether there will be a resurgence of a recurrent/annual fee model to provide regular ongoing cash flow that matches management requirements of an orchard or plantation. This may make commercial sense, but how can it be mandated or enforced? It is entirely inconsistent in a free market economy for government and regulators to tell businesses how to structure their fees or investment offerings.
3. Can we expect tougher financial covenants imposed on agribusiness operators by ASIC?
4. Enhanced disclosure generally. We do not consider there is a need for law reform in this area—the *Corporations Act 2001* requirements are already broad enough to require disclosure of the matters ASIC raised in its recent surveillance campaign. The reality is of course, there is a renewed focus on disclosure, and particularly whether certain things should have been said or disclosed more prominently, and so it will remain on the regulators' radar for a period of time.

## Inquiry

Against the backdrop of all that corporate turmoil, the parliamentary joint committee has held its inquiry into agribusiness schemes and reported to parliament on 7 September 2009 (please see the [article](#) below). Based on some of the content of that report we will see some change in the agribusiness investment sector.



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

## **The new order of agribusiness investment**

### **Reviewing structures**

As a consequence of the global financial crisis and the corresponding pressures on agribusiness, many agricultural scheme operators are reviewing the structure of their investment offerings.

We are starting to see some scheme operators move away from the stapled fund offering of a tax effective investment on the one hand and an infrastructure/land holding fund on the other. The transition has been towards the establishment of, or restructure to, more traditional unitised funds where passive investors contribute capital which in turn is invested in agricultural assets and infrastructure. Unlike the common agribusiness investment scheme structure, traditional funds are not as tax effective.

### **Agribusiness failures**

The past year has seen a number of agribusiness operators collapse, including Timbercorp, Great Southern and Australian Bight Abalone.

The agribusiness sector saw a plunge in the number of new investors from 2007-2008 to the current financial year and correspondingly, capital raising amongst agribusiness scheme promoters during the 2008-2009 financial year was significantly down on the industry's result for the previous year.

Great Southern and Timbercorp (the sector's two largest players) alone operated over 70 schemes between them. Their demise sparked a flurry of activity (including a Parliamentary Inquiry!), but also innovative moves by stakeholders considering how best to offer investors an interest in new vehicles which can take over some or all of scheme operations or assets.

### **Alternative structures**

In light of these events and the continuing pressure on agribusiness operators, several operators are looking to establish traditional unit trust structures as a means of raising capital to fund their agribusiness operators. Where stapled offerings have previously been made, some operators have also restructured their existing schemes by collapsing the tax effective project into the stapled infrastructure/land holding entity. Whilst traditional unit trusts and companies do not offer tax advantages as attractive as their agribusiness scheme counterparts, they are considered a viable alternative in the current climate for the following reasons:

1. Operators can reduce the investment's administration costs as the infrastructure/land and operations will reside in the one entity.
2. Access to borrowings can be improved given security can be provided by one consolidated entity.

3. Flexibility in operation is increased given the stand alone trust or company can look to sell or lease infrastructure, land and/or the business to a third party as a whole should such an opportunity arise in the future and be in the best interests of investors.

### Moving forward

Given the continued world demand for food and agricultural products, and the agricultural investment sector's resilience, it is expected agribusiness operators will continue to adapt to meet current situations. Whether this is achieved by establishing more funds structured in a traditional way, restructuring existing agribusiness schemes, or evolving new structures to meet any reform to managed investment schemes laws, remains to be seen.



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

## Are you 'carrying on a business'?

### Background

A recent decision of the Supreme Court of New South Wales considered what it means to be 'carrying on a business' as that expression is used in the *Corporations Act 2001* (Corporations Act).

Various sections of the Corporations Act make reference to the notion of 'carrying on a business'. For example, a person who carries on a financial services business must hold an Australian financial services (AFS) licence and if a managed investment scheme is promoted by someone who is in the business of promoting managed investment schemes, then the scheme may need to be registered.

### The facts

In the recent decision of *ASIC v Matthews*, ASIC sought an order against Mr Matthews on the basis he was undertaking the business of advising others about securities, publishing securities reports and dealing in securities in contravention of an earlier court order.

Matthews had sent approximately 1,650 letters addressed to trustees of self managed superannuation funds advising of an unnamed listed company he considered to be an attractive investment opportunity and inviting the funds to join with him in investing. He also made some comments about the returns investors could expect to receive.

The judge was of the view Matthews' letter constituted the publishing of analyses about shares, the giving of advice about shares and was an attempt to induce people to make agreements to acquire shares, all conduct which Matthews was prohibited from undertaking. But the question which remained for the court to determine was whether Matthews was 'in the business' of undertaking the prohibited conduct.

### **Carrying on business**

The *Corporations Act* does not define what it means to be 'carrying on a business'. However, the concept has been considered by judges in previous cases and there are well established common law guidelines which assist in making the determination. The following section from a well known case is often quoted:

*Speaking generally, the phrase "to carry on business" means to conduct some form of commercial enterprise, systematically and regularly with a view to profit, and implicit in this idea are the features of continuity and system.*

In the current case, the judge considered Matthews was conducting a business, because his sending of the letters amounted to widespread solicitation to interest others in entering into commercial transactions with him. His solicitation was methodical and systematic. He intended to transact with any of the recipients who expressed interest with a view to financial gain.

In another recent case of *ASIC v Cyclone Magnetic Engines Inc and others*, Cyclone Magnetic Engines Inc (CME) published information with a view to encouraging people to buy shares in the company. ASIC alleged CME was carrying on a financial services business involving making recommendations intended to influence persons in making a decision in relation to shares in the company. The judge was satisfied that merely promoting the issue of shares in one's own company does not, of itself, constitute a business and the one off nature of the behavior supported that conclusion.

### **Regulated conduct**

It is important to know what conduct is regulated by the *Corporations Act* and when licensing and registration will be required. It is also necessary to closely examine not only the principal activities of a business, but also any other activities which form a part of the business, to determine whether any of the licensing or registration provisions will apply to those activities.

Based on these cases, preparatory steps towards establishing a business or enterprise (even to produce your first transaction), could be considered 'carrying on a business'. This means it could be increasingly difficult to form the view that someone involved in or establishing a commercial transaction is not 'carrying on a business', even in respect of their first transaction.

Accordingly, anyone proposing to refrain from obtaining an AFS licence or registering a managed investment scheme on the basis they are not 'carrying on a business' should seek legal advice.



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

## Senate inquiry reports in

### Committee Inquiry report

On 7 September 2009, the Parliamentary Joint Committee on Corporations and Financial Services (Committee) tabled the final report of its inquiry into agribusiness managed investment schemes.

The two main chapters of the report deal with structural issues and investor protection. The Committee noted that the collapse of Timbercorp and Great Southern will focus investors' attention on the importance of investing in commercially viable schemes and therefore negate the worst effects of indiscriminate capital investment (perhaps the proverbial silver lining of a very dark cloud!).

### Recommendations

Nevertheless, the Committee has made the following recommendations:

1. That the government considers investigating and modelling the effects of amending the tax legislation to ensure that tax deductions for non-forestry schemes only be permitted to be offset against future taxable income from the same scheme.

The good news for forestry promoters is the Committee understands the long lead time before possible income discourages investment and so some tax incentive is required. The Committee also concluded the new taxation arrangements (in division 394 of the tax legislation) should be given the opportunity to work.

2. The government should amend the *Corporations Act 2001* to require the Australian Securities and Investments Commission (ASIC) to appoint a temporary responsible entity "when a registered managed investment scheme becomes externally administered or a liquidator is appointed". We assume this means when the responsible entity of the scheme goes into administration or liquidation given the scheme itself may still continue as a going concern despite the responsible entity's financial deterioration.

Interestingly, despite a number of submissions to the Committee raising concerns about some aspects of the managed investment scheme model (and particularly deferred fees) the Committee noted market forces, rather than legislative change, will pressure reform.

3. ASIC should require disclosure of the qualifications and accreditation of third parties that provide expert opinion on likely scheme performance.

The Committee otherwise noted that its broader inquiry into financial products and services is likely to report on other investor protection issues including standards of advice, remuneration models and investor education about investment choices (it did conclude agribusiness schemes are not in the category of investments that should be closed to the retail market, as suggested by some).

### Changes ahead

McMahon Clarke Legal's submission to the inquiry was that legislative reform is not required except in some specific instances including giving ASIC the power (and in fact the obligation) to appoint a temporary responsible entity when the current responsible entity goes into external administration. The existing laws are robust enough to achieve a fully informed and properly regulated investment market. It is of course incumbent on industry to ensure compliance with those laws.

We consider it is inevitable that ASIC will issue further guidance and requirements about the promotion and management of agribusiness schemes. That may not be imminent, but it is quite likely to happen. And if it is anything like the enhanced disclosure policies for unlisted property funds and debenture offers, then once ASIC decides to move, things will happen quickly. We will keep you advised of any such developments in future editions of *Growing Wealth*.



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

## **AUSTRAC is coming**

AUSTRAC, the anti-money laundering and counter-terrorism financing (AML/CTF) regulator, has commenced a surveillance program of fund managers, financial planners and custodians to ensure compliance with the anti-money laundering laws.

Up to 4,000 entities have been targeted for surveillance.

AUSTRAC's objective is to assess the policies, programs and processes companies have implemented to meet their obligations under the laws.

The regulator has stated the surveillance program represents a shift away from assisted compliance by AUSTRAC to a greater focus on securing compliance. Enforcement activity is therefore likely to be inevitable.

AUSTRAC will also be assessing whether entities have conducted effective independent reviews of their compliance programs as required by law.

If you need any assistance with your AML/CTF compliance, or you are subject to an AUSTRAC surveillance, then please contact Langton Clarke by **email** or telephone him on 07 3239 2926.

## **New staff announcement**

Sarah McDonald joined McMahon Clarke Legal in May 2009 as a solicitor in the corporate team.

Sarah holds a Bachelor of Laws (Honours) and a Bachelor of Business (Banking and Finance) from the Queensland University of Technology and a Graduate Diploma in Legal Practice from the College of Law.

Sarah previously worked for the Australian Prudential Regulation Authority (APRA), the prudential regulator of the Australian financial services industry. In this role, Sarah provided advice in the areas of corporate governance, risk management and compliance for credit unions, building societies, general insurers and superannuation funds.



**Sarah McDonald** can be contacted by email or on 07 3239 2957.

## Staff promotion

Nicole Singer has been promoted to the position of associate in our funds management team. Nicole is a specialist financial services lawyer with a focus on property funds management.



**Nicole Singer** can be contacted by email or on 07 3239 2906.

McMahon Clarke Legal specialises in legal services associated with funds management, capital raising and litigation and risk management for listed and unlisted entities. For a full list of our services, please visit the main part of our website at [www.mcmahonclarke.com](http://www.mcmahonclarke.com) or email us at [info@mcmahonclarke.com](mailto:info@mcmahonclarke.com).

To update your contact details or unsubscribe to this newsletter, [click here](#) to send us a note.

*This newsletter is produced as general information in summary for clients and subscribers and should not be relied upon as a substitute for detailed legal advice or as a basis for formulating business or other decisions. McMahon Clarke Legal asserts copyright over the contents of this document. You are free to copy and use this information, provided you inform McMahonClarke Legal first and acknowledge McMahon Clarke Legal as the copyright owner on any material produced.*

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