

Property Fund News April 2010

Alarm bells for voting exclusions

Recent case

A recent NSW Supreme Court decision will impact the ability of responsible entities with any conflict of duties to vote on behalf of members of their funds.

In *Everest Capital Ltd as Trustee of the EBI Income Fund v Trust Co Ltd* the court was asked to consider the voting exclusions in section 253E of the *Corporations Act 2001* (Act). Justice White found the trustee was not entitled to vote on behalf of members of another fund for whom it acted as responsible entity, because of the interest the trustee held in its personal corporate capacity in the outcome of the resolution. The resolution was to remove the trustee.

Conflict of duties

Justice White said the reason for his decision lay not in the fact that the trustee's personal interest and its duty as responsible entity conflicted, but the fact that there was a conflict of duties to begin with.

Importantly, this decision was made despite arguments that the Act requires a responsible entity to act in the best interests of members, and if there is a conflict between the members' interests and its own interests, to give priority to the interests of members. Additionally, the court heard that if the trustee were excluded from voting, then this would be denying voting rights to the members of the underlying fund.

Until the case of *Everest* is overturned, or a higher court subsequently decides the section should be interpreted differently, there is a real risk in allowing a responsible entity with any conflict of duties to vote.



If you would like more information, then please contact **Nicole Singer** by email or on 07 3239 2906.

Litigation news

Employment contract termination—avoiding claims

It is important to understand your contractual and statutory obligations before steps are taken to terminate an employee's employment.

In a Victorian Supreme Court case last year, an employer was ordered to pay a dismissed employee damages because it had elected to pay her 6 months wages in lieu of notice. Her employment contract simply provided for 6 months notice of termination to be given and did not state that payment could be given in lieu of notice. The judge found that she was disadvantaged by not being in current employment whilst attempting to secure a new job.

Small business employers (employing less than 15 full time equivalent employees) can protect themselves from unfair dismissal claims by following the Fair Dismissal Code (Code) introduced by the *Fair Work Act* in July 2009. If the [Code](#) is followed, then the dismissal will be deemed to be fair.

Whilst large business employers are not given the same protection, following the Code will go a long way to defending any potential claim for unfair dismissal.

Contact

If you would like some advice regarding your dismissal procedures or assistance reviewing the terms of your contracts of employment, 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 2914.

Bamford— Relief as High Court holds the line on trusts

Taxation of trusts

Over the last year, you have probably heard or read about an important test case on the taxation of trusts, referred to as the *Bamford* case. The full Federal Court handed down a decision in the case last year; and in March this year, the High Court dismissed appeals from the case, meaning the Federal Court's decision stands.

Tax practitioners and those who work with trusts (including fund managers) had been holding their collective breath to see which way the High Court would go. The Court's decision has delivered the certainty much sought-after, on some important points surrounding how beneficiaries of trusts should be taxed.

What was the case about?

Without going into the facts of the case, what was important is that the Court was asked to examine the concept of "income of a trust" for the purposes of the *Income Tax Assessment Act 1936* (Act) and decide whether it means "income" in accordance with ordinary concepts. There has for a long time been some debate over this question. There has also been debate around whether the "proportionate" approach or "quantum" approach is to be followed, when determining what a beneficiary of a trust should be assessed on for tax purposes. The High Court finally cleared this up as well.

What was the result on these main points?

These are the most important points arising from the decision:

1. The "income of" a trust for the purposes of the relevant provisions in the Act should be determined by looking at the actual trust deed (in the case of a fund, the fund's constitution) and normal accounting principles. What this means is that (despite the Tax Office's arguments otherwise), distributable "income" can be defined by the provisions of the trust deed and is therefore not necessarily limited to what might usually be considered "income". Trust deeds could therefore be drafted in a way so that, for example, "distributable income" might include amounts which would ordinarily be thought of as capital gains.
2. The "proportionate" approach is the correct approach to be followed when working out the share of the net income of a trust on which a particular beneficiary should be assessed. What this means (in short) is that the beneficiary is assessable on the same proportionate share of the "net income" of the trust as the beneficiary's proportionate share of the "income of" the trust.

What should you do?

The decision, whilst confirming what most tax practitioners suspected on these issues, does highlight how critical it is to get the distribution provisions and related definitions in your trust deed / fund constitution right; particularly to give you all of the flexibility you may need during the life of your trust or fund.

Standardised or "off-the-shelf" documents may not come up to scratch; and it is often only in hindsight that issues are picked-up, when it is commonly too late.

You should consider having your funds' constitutions reviewed from a tax perspective, to ensure they meet your funds' needs and give you all the flexibility you could want (or that you may think you already have). Also, you should resist the temptation to roll-out an existing old constitution when it comes time to set-up a new fund. This is the case for many reasons (not the least of which is ensuring you get the tax position right, from day one).



If you would like more information, then please contact **Matthew Moses** by email or on 07 3239 2922.

New MIS disclosure regulations

As we have noted in a number of previous articles in *Property Fund News*, the disclosure landscape for managed investment schemes (MIS) is changing. The Financial Services Working Group issued draft regulations for comment in December last year and the consultation period closed on 26 February 2010. The industry is now awaiting the outcome of that consultation and we can expect to see the finalised regulations some time in the first half of this year.

The regulations will mean a significant change in the disclosure obligations imposed on fund managers, however at this stage it appears that property funds won't be caught; but property securities funds will be.

For a more detailed explanation of the proposed regulations and their possible impact on the industry [click here](#) to read an article prepared by Brendan Ivers which was published in *Money Management* on 11 March this year.

Anyone interested in the issues with the new regulations can also [click here](#) to read the submission we prepared in response to the draft regulations.

Contact

If you would like any more information on how the regulations may affect you, then please contact Brendan Ivers, an associate in our funds management team.



Brendan Ivers can be contacted by email or on 07 3239 2922.

Trustee's ability to seek judicial advice

What is judicial advice?

In all Australian jurisdictions except Tasmania and the Northern Territory, there is legislation enabling a trustee (and responsible entity) to seek the Court's private advice about matters concerning what steps it should take in a particular situation which concerns the trust (or registered managed investment scheme as the case may be).

The function of the Court's private advice is to give personal protection to the trustee. Consequently, the advice, once given, is binding on all persons interested in the trust. This means if a trustee utilises this procedure, they will be protected from allegations of breach of trust if the advice is followed and will be entitled to rely on their indemnification from the assets of the trust for costs associated with following the advice.

This is a valuable protective mechanism for trustees and one which should be considered as part of a trustee's risk mitigation strategy in any decision concerning the trust which is likely to give rise to a claim.

How does a trustee apply for judicial advice?

The function of judicial advice is an exception to the Court's usual function; which is resolving disputes between opposing parties. Consequently, the process is supposed to be a cheap and simple mechanism for determining questions relating to the trust.

In theory, trustees can apply for and obtain judicial advice fairly quickly. Often the trustee will be the only party to the application (especially in non-litigious situations) and the trustee will provide the Court with the relevant facts and documents concerning the issue at hand. There is an onerous obligation on the trustee to make full disclosure to the court. In addition, the court will almost always defer a decision until all parties affected by the proposed advice have been given notice of the application and an opportunity to be heard in opposition. This means that the process can take two to three months and involve some expense to the trustee. Whether or not it would be worthwhile will depend on the nature of the decision, and the risk to which the trustee is exposed.

Trust reconstruction

One of the most common scenarios where a trustee seeks judicial advice is if it is proposing a trust reconstruction. Such reconstructions often involve complex arrangements with the trustee having competing and overlapping duties to different trusts, as well as its own self interest. The chances of having a conflict of interest are high.

In a trust reconstruction scenario, the trustee will seek advice that the trustee would be justified in making and implementing the reconstruction proposal. The benefit of seeking judicial advice is the protection from claims of breach of trust relating to the reconstruction from disgruntled investors.

Litigation

As a result of a 2008 High Court decision, the issue of obtaining judicial advice in a litigious context has become particularly important. In that case, the High Court had to consider a dispute concerning trust property where the trustee was accused of a breach of trust. The court found one of the reasons for enabling a trustee to obtain judicial advice is to resolve doubt about whether it is proper for the trustee to incur the costs involved with commencing or defending litigation concerning the trust.

The High Court in fact went a step further. Where a trustee is being sued for breach of trust, it said that not only can a trustee seek judicial advice but that it *should* seek judicial advice before taking any steps in defence of the action. This is an important mechanism to ensure the interests of the trust are protected.

Consequently, a trustee who fails to seek advice on the question of whether to defend an action may run the risk that their costs of defending the action may not be 'properly incurred expenses' for the purposes of their indemnification from the assets of the trust.

Summary

In summary, the key issues for trustees (and responsible entities) to know regarding judicial advice are as follows:

1. It is an important protective mechanism for trustees (and responsible entities).
2. It can be particularly useful in providing trustees with some protection if they are uncertain about whether to take a particular course of action concerning the trust.
3. It can provide trustees with some additional comfort in a trust reconstruction scenario.
4. Trustees should speak with their legal advisers about whether it is necessary to seek judicial advice about litigation concerning the trust.

McMahon Clarke can provide you with advice on all facets of judicial advice.



If you would like more information, then please contact **Brendan Ivers** by email or on 07 3239 2922.

Relief available for frozen funds

Unlocking frozen funds

You may have seen the recent media reports about "ASIC unlocking frozen funds". These reports relate to ASIC's recent confirmation that the standard relief it intended for frozen mortgage funds will be extended to other frozen funds, including unlisted property trusts.

The relief available to assist a frozen fund includes relief for—

1. hardship withdrawals, and
2. 'rolling' withdrawal offers.

Hardship withdrawals

The hardship withdrawal relief allows fund managers to treat some members differently for the purpose of withdrawals. The relief is designed to facilitate withdrawals by members who can show they are suffering hardship for reasons including compassionate grounds, permanent incapacity, unemployment and inability to meet living expenses. Conditions apply to the relief, including a cap on the number of withdrawals and the amount withdrawn per investor per calendar year.

Rolling withdrawal offer

The rolling withdrawal offer relief allows fund managers to make withdrawal offers to members on a rolling basis over a timeframe of one calendar year. Members can make a standing request to participate in any withdrawal opportunities that the fund manager provides over that 12 month period.

The relief requires the fund manager to specify the number and frequency of withdrawal opportunities it intends to make over the year and the terms upon which the opportunities will be made. Fund managers will still need to tell members how money will be raised to pay for the withdrawal opportunities, consistent with the current provisions of the *Corporations Act 2001*. Additional conditions apply to the relief, including the requirement for fund managers to remind members about their ability to participate and to use their website to provide up to date information about the rolling withdrawal offers.

Applications to ASIC

Both forms of relief are issued on a case-by-case basis following application to ASIC. McMahon Clarke Legal can assist you with these applications although we appreciate the relief itself is not going to solve liquidity issues where the cash required to fund redemptions is simply not available.



If you would like more information, then please contact **Nicole Singer** by email or on 07 3239 2906.

Legally binding agreements

Heads of agreement

It is common for transactions between parties to begin with entry into an initial heads of agreement. However it is critically important for the parties to consider whether they intend for that document to be legally binding.

In August 2008, Justice Chesterman of the Queensland Supreme Court held that Hebron Park Pty Ltd (Hebron Park) had entered into a legally enforceable

agreement with Moffat Property Development Group Pty Ltd (Moffat). The case is an interesting example of the pitfalls that parties can fall into.

Letter of offer

The "agreement" was contained in a letter of offer by Moffatt to Hebron Park described as an "unconditional offer" to purchase Hebron Park's land. The letter included the following details:

1. The purchase price
2. The deposit was payable upon execution of the contract.
3. The contract would be "unconditional in the form of a put and call" option.
4. Settlement was to occur 12 months from the date of execution of the contract.
5. There was a requirement for security in the form of a caveat or mortgage.
6. Moffatt's lawyer would prepare the contract.

Court of appeal

In March 2009, Hebron Park unsuccessfully sought to appeal the Supreme Court decision on the ground that the letter was not a binding agreement because:

1. The terms of the letter evidenced an intention not to be bound until a formal contract was executed, and
2. The terms of the letter were so uncertain that they could not be enforceable.

Intention to be bound

In a unanimous decision, the Court of Appeal found the terms of the letter and the surrounding circumstances evidenced an intention to be immediately bound. The following factors were significant:

1. The letter was described as an "unconditional offer" and a representative of Hebron Park was asked to "sign the letter of offer as accepted". Hebron Park's director gave an unqualified acceptance by signing the "unconditional offer".
2. Moffatt made an offer to Hebron Park's agent to purchase the land 12 months before the date of the letter which was not accepted because Hebron Park was negotiating with another potential purchaser. As the sale did not proceed, Hebron Park instructed its agent to locate a purchaser. The agent contacted Moffatt and negotiations between Hebron Park and Moffatt began. In these circumstances, it was held that both parties would have intended a concluded agreement to be made.
3. The offer in the letter was unconditional and the put and call contract was also described as unconditional. This indicated that the terms of the put and call contract would not be further negotiated and it was then an exercise for Moffatt's

lawyer to prepare the put and call contract containing the terms of the letter and further terms which were reasonable and relevant to the put and call.

4. The Court acknowledged the parties may disagree with the additional terms in the put and call contract drafted by Moffatt's lawyers. However, the Court held that the unconditional acceptance of the unconditional offer meant the parties had made a binding commitment and therefore had an implied obligation to co-operate with each other to ensure that each party obtained the benefit of its bargain. If one party failed to co-operate, then the innocent party could bring the contract to an end or enforce the contract.

Uncertainty

Hebron Park argued the terms of the letter were too uncertain and were therefore unenforceable because, amongst other things, the letter did not specify—

1. when the put and call option was to be exercised, or
2. the terms of the put and call option.

In rejecting the above arguments, the court held the terms of the letter were sufficiently certain as the above terms and other mechanical provisions could be implied into the contract by operation of law and considerations of reasonableness.

Reminder

This case is an important reminder to all parties involved in negotiations, particularly by correspondence, that they can be legally bound by an informal agreement. This will be so even where execution of a formal contract at a later date is contemplated.

If parties do not intend to be legally bound before a formal contract is executed, then it is imperative that an express statement to this effect be included in a letter of offer.



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

Queensland Land Tax update

Proposed changes

As many of you will be aware, the Queensland property industry underwent several weeks of real concern after the Queensland Government introduced the *Valuation of Land and Other Legislation Amendment Bill 2010* (Bill) in parliament on 11 February 2010.

A number of problems were identified in relation to the Bill, however the key concerns were as follows:

1. Under the original Bill, an assessment of '*unimproved value*' could include value of leases, goodwill, infrastructure charges and entrepreneurial and development profit. This represented a vast shift from the previous assessment of unimproved value and had the potential to result in large, unintended and often uncommercial increases in valuations. Many industry experts believed the change in methodology and the consequent increase in the cost of rates and land tax would ultimately have resulted in a loss in market value of between 10 to 20 percent for investment properties in Queensland.
2. The changes in valuation methodology were to operate retrospectively to 2002. In practice, it was impossible to see how this could work.

Amended Bill

After intense lobbying from groups such as the Property Council of Australia, the Shopping Centre Council of Australia and the Queensland Law Society, the Queensland Government agreed to major amendments to the Bill. The Bill was passed on 9 March 2010 in its amended form.

As a consequence, the current position is as follows:

1. The legislation has not been introduced retrospectively to 2002.
2. The Queensland Government has committed to a full review of the State's valuation system in time for the 2011 round of valuations. This means the current legislation will only impact the 2010 round of valuations. Expectations are valuations will generally be lower for 2010 due to the impact of the global financial crisis on the property industry. 2010 valuations issued to date appear to reflect this expectation.
3. The review will focus on a move to site valuations, which is consistent with the approach adopted in other states. This means that assessments of unimproved value involving reference to goodwill, leases and other contentious issues will not feature in Queensland's future valuation system.
4. The legislation contains a sunset clause, so that if the Queensland Government is unable to complete this review in time for the 2011 valuations, then the legislation will revert back to the legislative position prior to the introduction of the Bill.

Objections

While the amendments to the Bill only represent a short term fix, they at least allow time for the review process to take place with appropriate consultation involving all participants in the Queensland property industry.

In the meantime, owners intending to object to 2010 valuations should note the new legislation means objections must be lodged within 45 days of valuations being issued.



If you would like more information, then please contact **Mark Lyons** by email or on 07 3239 2981.

Staff promotions

We are proud to announce the following solicitors have received promotions in recognition of their skills, experience and achievements:

Brendan Ivers

Brendan Ivers has been promoted to the position of associate in the funds management team. Brendan has specialist expertise in the laws relating to managed investment schemes and also has a particular focus on advising clients in relation to banking and finance issues for managed investment schemes.

For more information, email **Brendan Ivers** or call 07 3239 2922.

Brit Ibanez

Brit Ibanez has been promoted to the position of associate in the litigation and risk management team. Brit has considerable experience in corporations law matters, (including shareholders' disputes), as well as contractual and joint venture disputes, and estate litigation.

For more information, email **Brit Ibanez** or call 07 3239 2960.

John Lane-Mullins

John Lane-Mullins has been promoted to the position of associate in the corporate team. John has a broad range of experience in capital raising and corporate advisory transactions, as well as in matters concerning anti money laundering and counter terrorism financing.

For more information, email **John Lane-Mullins** or call 07 3239 2926.

Laura Hanrahan

Laura Hanrahan has been promoted to the position of associate in the private client and business succession team. Laura specialises in estate planning, business succession and the administration of deceased estates. Laura regularly advises clients in relation to Wills, enduring powers of attorney, business succession agreements and probate applications.

For more information, email **Laura Hanrahan** or call 07 3239 2924.

Nathan Shaw

Nathan Shaw has been promoted to the position of associate in the litigation and risk management team. Nathan heads up our debt recovery team, and has a broad range of experience in property and leasing matters, managed investment scheme disputes, insolvency and trade practices disputes.

For more information, email **Nathan Shaw** or call 07 3239 2947.

McMahon Clarke Legal debt recovery services

One of the most common difficulties businesses face is managing cash flow. Too often, late payment from customers or clients cripples the ability of a business to pay its own debts.

McMahon Clarke Legal (MCL) has developed a fast, cost effective debt recovery system that can help you manage your receivables and cashflow.

Our focus

At MCL, we focus on—

- certainty of fees
- speed of delivery
- competitive rates, and
- quality of service.

Our services

If you engage our services, then—

- you will know what our fees will be before they are incurred
- your instructions will be acted on immediately, and
- you will have a solicitor in control of your matter at all times.

Our fees

We offer fixed fee arrangements with volume discounts for all recoveries where the debtor does not dispute the debt. Our fixed fees apply from sending a letter of demand to completing bankruptcy or winding up proceedings so that you know what you will pay throughout the process. We actively encourage debtors to be open about their financial capacity and we are available to you to offer sound commercial advice to assist you in your decision making in circumstances where

debtors wish to enter into some form of payment plan.

Our fees (excluding GST and outlays) for sending a letter of demand start at \$40 per demand and our fees for commencing court proceedings start at \$200.

For a copy of our complete fee schedule or to discuss our services in more detail, please contact Nathan Shaw.



Nathan Shaw can be contacted by email or on 07 3239 2947.

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 or email us at info@mcmahonclarke.com.

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