Chapter 12 External administration

Template for submissions

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12.1 Remuneration and expenses in the winding up of a scheme

Question 12.1.1
Should a scheme liquidator, or other person charged with the winding up of a registered scheme, be given a statutory right to claim remuneration and expenses of winding up the scheme and, if so, what form should it take?

Submission

Under the Corporations Act, liquidators are appointed in relation to companies not schemes. A liquidator of a responsible entity may assume that it is also liquidator of the scheme but this is not necessarily the case because the insolvency of the responsible entity does not necessarily mean the scheme is insolvent.

Elsewhere in these Question 12 submissions Primary Securities points out how inappropriate it is for a liquidator of a responsible entity to also be liquidator of a scheme.

There is already sufficient authority at common law for liquidators to be remunerated from scheme property for its expenses in winding up a responsible entity when the liquidator also winds up the scheme.

Question 12.1.2
Should the Corporations Act provide that the liquidator of a registered scheme (or other person charged with the winding up of the scheme) is not liable to incur any expense in relation to the winding up of the scheme unless there is sufficient available property?

Submission

Liquidators already claim this to be the case.

Primary Securities has experienced first hand many dealings with conflicted REs purporting to act in the interests of scheme members (and claiming the costs of so acting from scheme property) but in reality acting to advance the interests of ordinary creditors.

The problem is that the power is sometimes inappropriately used for the benefit of the ordinary creditors at the expense of the scheme members.

When it is in the interest of the ordinary creditors, liquidators of forestry schemes are quite prepared to incur expense on behalf of a scheme (and then claim a lien for the costs) to:

- commission an opinion to the effect that the rent the RE is obliged to pay under a head-lease is indexed when indexation had hitherto clearly been waived [Gunns 2000 and 2001] which achieved the purpose of frightening a prospective replacement responsible entity (Primary Securities) from taking on the liability.

- commission lawyers to explain the obligations of being RE, when the RE had no intention of carrying out any work on the ground [Willmott Forests].

- commission an expert's opinion in relation to the viability of the scheme which is not made available to the scheme members to enable them to satisfy a prospective RE that the scheme was viable [Willmott Forests].

See also the answer to Question 12.1.4.

Question 12.1.3
Should the court or ASIC have a power to direct a liquidator of a registered scheme (or other person charged with the winding up of the scheme) to incur an expense where a creditor is willing to indemnify that person and, if necessary, give security for the expense?

Submission

Yes.

Question 12.1.4
Should the court have a power to make such orders as it deems just with respect to the distribution of scheme property whose recovery, protection or preservation has been assisted by money contributed by particular creditors?

Submission

Yes, they already do have this power. However, from the perspective of the scheme members, the exercise of this power becomes complicated when the liquidators are conflicted.

Liquidators usually do not recognise that their paramount duty is to the scheme as required by section 601FD(2). Their usual position is that their paramount duty is to the secured and ordinary creditors. Therefore to have liquidators in control of an RE and exercising the powers of the RE without accepting corresponding duties to scheme members is dangerous. An example of what can happen is how the liquidators of Willmott Forests have treated members of the Willmott Forests schemes.

The main asset of the liquidators of Willmott Forests Ltd, PPB, was land some of which was unencumbered by any mortgage but some was encumbered.

The land was subject to very long term leases to scheme members in many registered and unregistered managed investment schemes on which all rent had been paid in advance (with some exceptions). The value of the land encumbered by these long term leases was only $2m, but without these long term leases the value was $40m. The difference between the two values was $38m. In other words, the value of the schemes was $38m and the value of the land for creditors was $2m. If the land had to be sold with the leases in place, the liquidators were at risk of not receiving sufficient proceeds to pay for their own fees, particularly as they had borrowed several million dollars without security.

What the liquidators did will demonstrate that a scheme cannot be left in the hands of the liquidators of an insolvent RE because they are unable to overcome the conflict issues.

In a very short campaign, the liquidators sought replacement managers or responsible entities for the schemes but only invited responsible entities who would take on the burden of paying for completion of the schemes over 20 years, an unrealistic objective. The liquidators did not contemplate or initiate any proposal for the continuation of the schemes as contributory schemes, in which the scheme members might begin to pay fees and rescue themselves. The campaign to find replacement REs of course failed.

The liquidators then sought approval of the court to sell the trees (which were scheme assets) with the land, on the basis that the campaign to find replacement REs had failed. This court application ignored the fact that the main asset for the scheme members was their long term leases on which rent had been prepaid, and not just the immature trees.

The liquidators (who owned the land but not the trees) then advertised the land and trees together and asked the **purchasers** to allocate the purchase price between the land and the trees. When dealing with the owner of the land (and not the trees), purchasers are hardly likely to allocate to the detriment of the land owner. The liquidators have kept confidential the purchasers' allocations.

The purchaser's allocation for the Bombala schemes overall was so extreme in favour of the land (as opposed to the trees) that the liquidators tried to adjust the allocation with what was called the "Bombala Adjustment", increasing the amount offered for the trees, and reducing the amount to be paid for the land. The receivers refused to agree to this adjustment, as a result of which no adjustment was made in relation to the secured land.

Having gone through this exercise, the liquidators then allocated the sale costs in the proportion 32% to the scheme members and 68% to the ordinary creditors and then deducted the 32% of the sale costs from the price paid for the trees, as a result of which, for most schemes, the scheme members received nothing.

When the 95-99 scheme members sought to appoint a replacement responsible entity and convert the scheme into a contributory scheme, both the receivers and the liquidators commenced proceedings against the individual scheme members who called the meetings, for an injunction to restrain the meetings. The grounds for restraining the meetings were that the conversion of the scheme into a contributory scheme constituted a fraud on the minority scheme members who did not wish to pay any more fees, as their interest would be diluted. The principle of fraud on scheme members (the *Gambotto* principle) has only ever been applied to trusts and companies and not to contractual schemes which depend on fees being paid, so the claim was spurious.

Primary Securities was eventually appointed as the new RE but the liquidators continue to own the land and are not cooperative in relation to any matter and have taken many possible points at law at cost to the scheme members. Scheme members and their association Willmott Grower Group have so far endured five court proceedings including a High Court Appeal.

When the 95-99 scheme members (through Primary Securities) recently sought to purchase the land (and additional forestry land) to remove this problem, the liquidators refused to allow inspection of the additional land or provide due diligence materials to enable the scheme members to proceed with any purchase offer.

Question 12.1.5
What, if any, other provisions might assist a liquidator or other person charged with the winding up of a registered scheme in meeting the expenses of the winding up?

Submission

A better solution is the SLE Proposal.

12.2 External supervision of a scheme winding up

Question 12.2.1
Should there be external supervision of the winding up of a managed investment scheme and, if so, in what circumstances and by whom?

Submission

12.3 Disclaimer of leases

Question 12.3.1
Should the liquidator of an RE that is a lessor of property have the power to disclaim a lease of property under which scheme members are the lessees?

Submission

The High Court has pronounced on this issue. The liquidator of an RE (or any liquidator) that is a lessor of property does have the power to disclaim the leases. This will now act to the detriment of the forestry industry and many other industries with long time scales as no-one will want to enter into long term leases for fear that the owner will become insolvent and disclaim their leases.

Question 12.3.2
If the liquidators of lessor REs continue to have the power to disclaim leases with member lessees, should those who intend to become lessee investors have the benefit of disclosure of the possible consequences of a liquidation of the RE in relation to the interests that they intend to acquire in the scheme?

Submission

Yes, the possible disclaimer of leases by an insolvent land owner is now a risk of agricultural schemes and any business where property is leased.

What disclosures are made in any disclosure document is up the relevant RE. The Corporations Act should not try to prescribe what might be disclosed.

12.4 Duties and obligations of officers of an RE in financial difficulties

Question 12.4.1
Should the definition of 'officer of a corporation' be amended to clarify whether an external administrator of the RE of a managed investment scheme is, or is not, covered by the definition?

Submission

Yes. It is understandable that receivers are not bound to the duties of officers of an insolvent responsible entity but liquidators and administrators should be, and those duties should be paramount. Scheme members need some party to represent them and protect them. When the responsible entity is insolvent, scheme members are in a poor negotiating position and not having the active protection of a responsible entity can be very detrimental to their interests as explained above.

Question 12.4.2
If it is made clear that the definition extends to external administrators of an RE:

- should it apply to all provisions affecting officers of the RE and, if not, which provisions should be excluded and why
- should it apply to all external administrators of the RE and, if not, which categories of external administrator should be excluded and why?

Submission

The definition should not apply to receivers, but should apply to all other external administrators of an RE. A better solution is needed than to clarify who are officers of the RE.

Question 12.4.3
Should the duty of officers of the RE to act in the best interests of members be modified to allow for the situation where the scheme is, or is likely to become, insolvent?

Submission

No, this will lead to the same conflicts scheme members of agricultural schemes have experienced.

12.5 Notification of appointment of receiver

Question 12.5.1
Should the public notification requirements on appointment of a receiver to property of a corporation be amended and, if so, how?

Submission

Yes. If a scheme has become insolvent, such as a trust, in most cases the responsible entity is not personally liable for any debts as the responsible entity is usually protected by a covenant that any liabilities to the creditor / bank are limited to the assets of the scheme. It is therefore inappropriate for a notice of receivership to be shown against the name of the responsible entity as it is not the responsible entity which is in receivership, or any of its personal assets, but the assets of the scheme.

In many cases, notwithstanding the "single responsible entity" system, a trust or scheme is in fact managed by another entity and the trustee merely has an oversight role. Not all liquidations are the result of poor management, the global financial crisis was such a severe storm it undid many trusts, some of which are still frozen after 6 years.

Question 12.5.2
How significant is the problem identified in Section 12.5 in practice?

Submission

The problem is significant for the following reasons:

- The law should encourage companies to serve as trustees
- It can be very damaging to a professional trustee / responsible entity if the scheme has become insolvent but the trustee is not.
- It is misleading to show the responsible entity as subject to receivership when it is only a trust

operated by the responsible entity which is in receivership.

Other comments

Please insert any other comments you may have on the matters covered in this chapter.

Submission

What should ASIC do when an RE is non-compliant?

An RE can become non-compliant for a number of reasons including:

- The RE is insolvent, and an administrator, receiver and manager, or liquidator have been appointed;
- The RE does not have sufficient assets or cash or its 12 monthly forecast shows that there will be insufficient assets or cash at some point during the next 12 months;
- The RE has lost one of its responsible officers relevant to the scheme and not replaced that person;
- The RE does not have the required professional indemnity or fraud insurance;
- The RE is late in lodging its financial statements;
- The RE is in default of its external resolution requirements;
- The RE has breached the related party provisions.

Primary understands that the current policy of ASIC is to treat the RE as an asset which could possibly be sold for the benefit of ordinary creditors of the corporate group that includes the RE. This policy is a poor one because it prefers ordinary creditors of companies in the same group over scheme members (quite contrary to section 601FD(2)) and can leave scheme members essentially unrepresented or at the mercy of liquidators who are in a serious conflict as explained further below.

Primary Securities took over one property scheme which had been in receivership with no active responsible entity for 8 years (Ferndale Unit Trust). In all that time, the scheme members had never been represented or reported to. ASIC had even granted an exemption to the receivers from having to carry out the statutory obligations such as financial reporting.

Primary Securities was appointed by the Supreme Court on the application of some of the scheme members. Primary completed the financial statements and tax returns for the 8 previous years, collected outstanding rent and subsequently sold the main asset of the scheme and returned capital to the long suffering unit holders.

Receivers and liquidators controlling non-compliant REs are non-compliant, unqualified and inexperienced and are subject to serious conflicts of interest if they try and operate a scheme. The policy of many receivers is now not to take over RE functions (because of the problem of this conflict

of interest). They leave the task of running the RE to liquidators who often have no assets and must generate funds from scheme assets to pay their fees. This leads to serious conflict with scheme members (see the notes above in relation to Willmott Forests Ltd).

In these circumstances, the SLE proposal is an excellent solution as it enables a solvent RE to take over an insolvent scheme without personally incurring the obligations of the scheme.

There is another possible solution to the problem, which is to legislate to enable ASIC to require any non-compliant RE to write to its members to inform them that it is non-compliant, setting out the reasons why it is non-compliant, and inviting them to find a new RE.

If the RE fails to do that, then ASIC should remove its AFSL because removal of the AFSL will enable a court to more readily appoint a replacement RE under section 601FN.