

Article Information

Author: Lisa Gallate

Service: Dispute Resolution & Litigation

High Court examines Responsible Entity's ability to distribute Scheme Property

On 5 November 2014, the High Court issued its decision concerning the power of the Responsible Entity of a Managed Investment Scheme to distribute actual Scheme Property other than cash to Scheme Members.

On 5 November 2014, the High Court issued its decision concerning the power of the Responsible Entity of a Managed Investment Scheme to distribute actual Scheme Property other than cash to Scheme Members.

Factual Background

Wellington Capital Ltd (Wellington) was the Responsible Entity of a Managed Investment Scheme, the Premium Income Fund (the Scheme). The scheme was chiefly invested in mortgages, equities, debt instruments and cash (the Scheme Property). Perpetual Nominees Ltd (Perpetual) was the custodian of the Scheme, appointed as Wellington's agent to hold "Scheme Property" on behalf of Wellington. Under the Constitution of the Scheme, the members had an undivided interest in the "Scheme Fund", which was defined in the Constitution as all of the Scheme Property, subject to the liabilities at that time of the Scheme.

In September 2012, Wellington sold approximately 41% of the assets of the Scheme Property, to Asset Resolution Ltd (ARL), in return for shares in ARL that ARL issued to Perpetual. At the same time, Wellington instructed Perpetual to transfer the ARL shares to the unit holders in the Scheme, in proportion to their individual unit holdings.

The Australian Securities and Investments Commission (ASIC) challenged the validity of the transfer in the Federal Court, where its application was dismissed. Subsequently the Full Court of the Federal Court allowed an appeal, holding that the distribution of Scheme Property in specie, (i.e. the ARL shares), was beyond the power of Wellington under the Scheme Constitution and a contravention of s 601FB(1) of the Corporations Act 2001 (Cth)(the Act), which requires the Responsible Entity to perform its functions according to the Scheme's Constitution and the Act.

Power to distribute

Wellington relied on s 124(1)(d) of the Act, which provides that a company has the power to "distribute any of the company's property among the members, in kind or otherwise" and argued that since it had legal title to the shares, it could transfer legal title to the unit holders. Wellington asserted that clause 13.1 of the Constitution, which gave Wellington "all the powers in respect of the Scheme that is legally possible for a natural person or corporation to have" included s 124(1)(d). Wellington also relied on clause 13.2.5, which allowed it to "dispose of... or otherwise deal with Scheme Property as if the Responsible Entity were the absolute and beneficial owner". However, on appeal to both the Full Court of the Federal Court, and the High Court, those arguments were rejected.

Full Federal Court

The Full Court emphasised the trustee capacity in which Wellington held the Scheme Property. Pursuant to s 601FC(2) "the responsible entity holds scheme property on trust for scheme members", such that the processes of the Scheme Constitution (including clause 13.1) which conferred wide powers on the Responsible Entity to deal with the Scheme Property had to be approached through the "prism of trust law". The incorporation by indirect reference in clause 13.1 of the powers conferred on a company by s 124, did not therefore confer a power to distribute Scheme Property to members of the Scheme, without their consent. Further, the Full Court held that s 124 referred to the distribution of company property to members of a company, and not to members of a managed investment scheme.

High Court

Application of trust law

The High Court considered that the extent to which general principles of trust law apply to a Responsible Entity's function depend on the purpose of the statutory trust, the Act and the terms of the Scheme Constitution. Wellington, as the Responsible Entity, had duties imposed on it by s 601FC(1) of the Act, including a duty to act honestly, a duty of care and diligence, and a duty to act in the best interests of the members. In addition, Wellington had the duties of a trustee under s 601FC(2), and accordingly the duties of a fiduciary. The High Court emphasised that these trustee obligations were statutory in nature, and did not arise as an operation of general law.

Constitution

Under the Scheme Constitution, Wellington was empowered to issue units to the members of the Scheme. A unit holder had an undivided interest in the Scheme Fund and the Scheme Property as a whole, and had no interest in any particular part of the Scheme Fund. Clause 16 provided for the return of capital which the Responsible Entity had decided should form part of the Distribution Entitlement. The High Court considered that it did not contemplate the transfer of assets in specie, but rather, the formula in clause 16 provided for payment in cash. Contrary to Wellington's assertions, the clause "was not the source of a general power to distribute Scheme Property to unit holders... [i]t was not indicative of any implied general power to distribute capital at any time and, a fortiori, was not indicative of a power to make a distribution of Scheme Property in specie." Wellington also relied on clause 26.7 that provided for unclaimed or undistributed "money or other property" to be transferred to ASIC in the event of a winding up. However, the High Court held that this was confined to the winding up process, and did not support a contention that Wellington had a general power to distribute property other than cash.

Duties inform Constitution

Of central importance to the High Court's decision was that the Constitution had to be read subject to the statutory duties and fiduciary obligations of the Responsible Entity. Those duties and obligations constrained the powers set out in clause 13. Also, the controls on related party transactions in Part 5C.7 of the Act constrained the Responsible Entity's power to deal with the Scheme Property as though it were its own. These duties pointed to clause 13 being an enabling provision. Thus clause 13.1 and 13.2.5 "had nothing to do with the circumstances in which assets or capital forming part of the Scheme Property could be returned to unit holders." It was irrelevant that an absence of power to do so could leave the Responsible Entity with illiquid assets which could not be distributed to unit holders.

In that event, the High Court maintained, there should be an amendment to the Constitution or even a winding up of the Scheme pursuant to s 601NC(1) on the basis that its purpose couldn't be accomplished. Alternatively, the other mechanism for the return of Scheme Property by way of capital would be upon a winding up, pursuant to clause 26 of the constitution or otherwise under the provisions of Part 5C.9 of the Act.

Accordingly, the High Court upheld the Full Court's declaration that a transfer of the Scheme Property in specie was beyond Wellington's power, and it was left to each unit holder to decide whether it would accept the transfer, seek to rescind the transaction, or take other appropriate action.

For further information, please contact [Lisa Gallate](#).