

Funds Management & Financial Services Alert

Court overturns decision about use of responsible entity's 'natural person' powers

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In brief:

- The full Federal Court overturned the primary decision and agreed with ASIC that the fund manager had acted beyond its powers in demerging a significant proportion of the fund's assets without consent of the members.
- It is a fundamental principle of the law of trusts that a trustee must adhere to the terms of the trust, and a beneficiary may direct the trustee to transfer trust property to him or her but absent the consent of all beneficiaries it is not open to a trustee simply to transfer the trust property to the beneficiaries.

In October 2012, we reported on the decision in *Australian Securities And Investments Commission V Wellington Capital Ltd and Others (2012) 91 ACSR 514* which involved the demerger of assets from the Premium Income Fund (PIF), managed by Wellington Capital Limited (**Wellington**).

In that case, the Australian Securities and Investments Commission (ASIC) was unsuccessful in challenging whether Wellington was legally able to distribute shares, as opposed to cash, to the unit holders in PIF. The action was dismissed by a single judge of the Federal Court and ASIC was ordered to pay Wellington's costs.

ASIC appealed, and the full court of the Federal Court overturned the primary judge's decision. Wellington is seeking special leave to appeal to the High Court.

Facts

The units in PIF are listed on the market operated by National Stock Exchange of Australia Limited (**NSX**).

On 5 September 2012, Wellington announced to the NSX that it had sold \$90.75 million in assets of the PIF to a newly incorporated entity called Asset Resolution Limited (**ARL**). The assets included seven mortgage loans for development projects located in Victoria, Queensland and New South Wales, \$3.764 million in cash and all of the PIF's interest in the ASIC compensation claim relating to the MFS Group (now known as Octaviar) and the proof of debt in the liquidation of two MFS Group entities.

In return for the transfer of the assets, Wellington received 830,532,768 shares in ARL which represented 100% of the issued capital in ARL. Relying on general trustee powers in the PIF's constitution, Wellington then distributed those shares to PIF unit holders on a pro rata basis in accordance with their unit entitlements. The result of the transaction was the PIF unit holders now hold units in PIF and shares in ARL.

Wellington did not consult with or obtain the consent of the PIF unit holders to the distribution of the PIF's ARL shares to the PIF unit holders.

ASIC objected to the in specie distribution on the grounds that the constitution of the PIF did not permit it. ASIC applied to the court seeking a declaration that any the distribution of ARL shares to the PIF unit holders was invalid and that the ARL shares must remain the property of the PIF (and not individual unit holders).

The PIF constitution contains very broad trustee powers, which were typically included in constitutions for managed investment schemes established at the time PIF was established in 1999. Specifically, the constitution provided that “the Responsible Entity shall have all the powers in respect of the Scheme that is legally possible for an actual person or corporation to have and as though it were the absolute owner of the Scheme Property and acting in its personal capacity”.

The constitution also included standard clauses relating to the method and formula for making distributions to unit holders. However, ASIC argued that these clauses only allowed for distributions to be made by cash and not in specie, and that these clauses qualified Wellington’s general trustee powers.

Wellington relied on its general trustee powers as giving it the right to make the in specie distribution without unit holder consent, and that the clauses in the constitution about distributions of income did not limit these more general powers. Specifically, Wellington relied on the general trustee powers granting it the right to do whatever a company could do with the scheme’s assets, and referred the court to the power of a corporation in section 124(1)(d) of the *Corporations Act 2001* (Cth) (**Corporations Act**) to distribute “any of the company’s property among the members, in kind or otherwise”.

The initial decision of the court

In the primary case, Justice Jagot agreed with Wellington’s arguments relating to the construction of the constitution. She held that the lack of detailed provisions about an in specie distribution in the constitution (other than on a winding up) did not qualify Wellington’s general trustee powers to do with the scheme assets whatever a corporation could do with its assets as if it were the absolute owner of those assets and acting in its personal corporate capacity. In addition, she said that when unit holders became members of PIF, they also became subject to and bound by the terms of the constitution which granted broad powers to the responsible entity. Unit holders must therefore accept the exercise of those powers.

The decision on appeal

On appeal, the full court of the Federal Court overturned the decision of the primary judge.

It said that:

- it is a fundamental principle of the law of trusts that a trustee must adhere to the terms of the trust;
- a beneficiary may direct the trustee to transfer trust property to him or her but absent the consent of all beneficiaries it is not open to a trustee simply to transfer the trust property to the beneficiaries;
- the steps taken by Wellington amounted to a partial retirement from office other than in accordance with the provisions of the Corporations Act and it did so without consent of the unit holders by handing over to them a substantial part of the PIF property which constituted approximately 41% of the assets of the PIF;
- shares in a company are an entirely different species of property from units in a managed investment scheme and the unit holders had become members of the scheme on the basis they would own units and not shares; and
- the distribution of the shares in ARL to the unit holders of the PIF was contrary to the terms of the constitution and was done without power.

Consequences for fund managers

Wellington has lodged an application for special leave from the High Court to appeal the judgement of the full Federal Court. Until this application has been resolved, fund managers should be cautious about how they use their broad powers under a scheme’s constitution. If in doubt, it is always best to get a mandate from investors or a direction from the court about how your trustee powers can be used.

Please contact Chris Mee for further information.

Chris Mee
Special Counsel
+61 7 3338 7589

cmee@thomsonslawyers.com.au

For further information, please [click here](#) to contact our national Funds Management & Financial Services team

www.thomsonslawyers.com.au