8. Terminating, winding up and voluntary administration of a scheme

Introduction

8.1 This chapter considers the termination and winding up of collective investment schemes. It also considers issues arising when collective investment schemes or their operators become insolvent. Because a collective investment scheme does not have a separate legal identity, a distinction needs to be drawn between the termination of a scheme and its subsequent winding up. Termination refers to the scheme ceasing to operate as a scheme — essentially, taking no more subscriptions or ceasing to carry on the business for which the scheme was set up. Winding up refers to the collection and liquidation of assets, the payment of debts of the scheme and the distribution of the surplus, if any, in accordance with the scheme's constitution.

Grounds for terminating a scheme

The present law

8.2 The trustee of a prescribed interest scheme must convene a meeting of interest holders to consider whether the scheme should be wound up if any of three events occur:

- if the management company is being wound up
- if the management company has, in the opinion of the trustee, ceased to carry on business
- if the management company has, in the opinion of the trustee, failed to comply with a provision of the deed to the prejudice of holders of interests in the scheme.[1]

Winding up requires both a resolution of investors and approval by the court. The Corporations Law does not make any other provision for the winding up or interim administration of an insolvent prescribed interest scheme. Trust deeds, however, often provide that the trust is to be terminated three months after the manager gives written notice to the trustee.

Should termination be necessary?

8.3 The rule against perpetuities (more correctly described as a rule against remoteness of vesting) limits the life of trusts.[2] A collective investment scheme that is a trust may infringe this rule where its constitution does not specify limits for the

1. Corporations Law s 1074.
2. The rule provides that an interest in property not vested at its creation, in order to be validly created, must vest, if it vests at all, not later than 21 years after the termination of a life or lives in being at the date of the creation of the interest: RP Meagher & WMC Gummow *Jacobs' Law of Trusts in Australia*, 5th ed, Butterworths, 1986, para 930.

vesting of property held under the trust. The Corporations Law already addresses this problem in relation to trusts for the benefit of employees of a corporation by excluding them from the application of the rule against perpetuities.[3] The CSLRC Report concluded that the rule against perpetuities should not apply to participatory investment schemes.[4] The Review agrees. It **recommends** that the exclusion of the rule against perpetuities in the Corporations Law should be extended to all collective investment schemes. Collective investment schemes will therefore be able to continue indefinitely, provided their constitutions so allow and they are not terminated.

Termination under the constitution

8.4 Not all collective investment schemes are intended to continue indefinitely. The constitution of a scheme may specify events or states of affairs whose occurrence will cause the termination of the scheme (for example, by specifying a particular termination date). However it is not in the interests of investors for a scheme operator to seek to entrench itself through a termination provision. The Review **recommends** that any provision in the constitution that would terminate the scheme if the scheme operator is removed should be ineffective.

Termination by investors

8.5 *General procedure*. DP 53 proposed that investors should have the right to terminate a collective investment scheme where the scheme operator

- suspends redemptions from the scheme
- ceases to carry on business
- has its licence suspended or revoked in relation to the scheme.[5]

The Review now considers that the rights of investors to terminate a scheme should not be so limited. If a sufficient majority of investors wish to terminate a scheme, they should be able to do so. The Review **recommends** that investors should be able to terminate a collective investment scheme, for any reason, by the vote of the holders of more than 50% of the value of the interests in the scheme (other than interests held by the scheme operator or its associates).[6] The high threshold of 50% ensures that investors cannot have the scheme terminated without their involvement. Investors aggrieved by a termination resolution could challenge it for oppression or on the grounds that the resolution was not passed in accordance with the law.

8.6 *Insolvent schemes*. The Review considers that there should be a lower threshold than 50% of all investors for terminating an insolvent scheme. It **recommends** that investors should be able to terminate an insolvent scheme by special resolution of three quarters of the investors by value (other than the scheme

3. s 1346.
4. CSLRC Report *Prescribed Interests* 1988 para 96.
5. Proposal 7.15.
6. The rules in relation to voting on a resolution, including those affecting interests held by the scheme operator or its associates, are discussed at para 11.26, 11.27.

operator and its associates) voting on the resolution. This method of terminating a scheme should only be available where the scheme operator has obtained a certificate from an external auditor stating that the scheme is insolvent.

Termination by the court

8.7 ***Just and equitable ground.*** Investors may apply to the court for relief on the ground of oppression. One of the remedies that the court can grant on such an application is to order that the scheme be terminated.[7] A court may also order that the scheme be terminated after considering a report by a temporary operator appointed by the court.[8] However, these limited circumstances may not give the court enough control over collective investment schemes. The Review **recommends** that the court should have the power to terminate a scheme whenever it is of the opinion that it would be just and equitable to do so. The following parties should be entitled to apply to the court for termination on this ground:

- the ASC
- the scheme operator or temporary scheme operator
- a director of the scheme operator
- an investor.

An individual director of a scheme operator might apply in response to actions of the majority of directors which he or she considers not to be in the interests of investors. An individual investor might apply for a termination order where he or she believes termination is necessary. Courts could control vexatious or unmeritorious applicants through appropriate cost orders.

8.8 ***Insolvency.*** The Corporations Law Pt 5.4 permits the court to order the winding up of an insolvent company.[9] An application for winding up may be made by the company, a creditor, a contributory, a director, a liquidator or provisional liquidator, the ASC or a prescribed agency.[10] There are significant differences between companies and collective investment schemes which will increase the incentive for scheme creditors to move against the scheme operator rather than wind up the scheme. While a company is a separate legal person, a scheme is not. Where schemes are constituted as trusts, the scheme operator will be personally liable for debts of the scheme, but will have a right of indemnity out of the scheme property. Creditors will therefore generally take action to recover their debts, including insolvency proceedings, directly against the scheme operator. The Review endorses as equally applicable to collective investment schemes constituted as trusts the recommendations made in the ALRC's report *General Insolvency Inquiry* (ALRC 45, 1988) concerning the right of indemnity of a trustee of a trading trust.

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7. For the oppression remedy, see para 11.33.
8. For the appointment of temporary scheme operators see para 14.20.
9. s 459A. This is referred to as 'winding up in insolvency'. References to the insolvency provisions take into account the amendments introduced by the *Corporate Law Reform Act 1992* (Cth). Those amendments, which broadly implement the recommendations of the ALRC's report *General Insolvency Inquiry* (ALRC 45) come into force in June 1993.
10. Corporations Law s 459P(1).

- A provision in a trust deed excluding the trustee's right of indemnity against the trust property should be void against the liquidator. The effect of this recommendation is that the Corporations Law s 233 will not apply to collective investment schemes that are trusts. The interests of investors are protected as their personal liability for scheme debts is confined to any amount unpaid on their units.[11]

- The trustee's right of indemnity against the trust property and any right of indemnity against the beneficiaries should be a collective right exercisable by the liquidator on behalf of all trust creditors. The right should be subject to an order of the court. A court order may be necessary, for example, to protect the rights of secured creditors.[12]

- Assets recovered as a result of the exercise of the trustee's right of indemnity should be reserved for the payment of trust creditors.[13]

- Proceeds should be distributed, first, to pay costs associated with the exercise of the right of indemnity and the administration of property obtained as a result of the exercise of the right, and, secondly, to pay the administration costs of the winding up.[14]

- The right of indemnity should include not only the amount of the trust debts and liabilities but also the total costs associated with the winding up.[15]

The insolvency provisions of the Corporations Law, including the provisions for increasing the assets available to creditors by recovery of preferences, will apply in proceedings against the operator. If the collective investment scheme is a partnership, creditors will have joint and several rights against each of the partners unless it is a limited partnership. Creditors will therefore take action for recovery of debts against the partners. Insolvency proceedings against the partners will be governed by the *Bankruptcy Act 1966* (Cth) or the Corporations Law, depending whether the partners are individuals or companies. Creditors would therefore not usually be interested in taking action to wind up a collective investment scheme. Nevertheless, a procedure should be available for winding up a collective investment scheme in insolvency. The Review **recommends** that the court should have the power to terminate an insolvent scheme on application by a creditor, the scheme operator, a director of the scheme operator, a liquidator or provisional liquidator of

11. ALRC 45 para 251. The Review recommends at para 11.37 that the liability of investors in collective investment schemes that are trusts should be limited.
12. ALRC 45 para 261.
13. ALRC 45 para 265.
14. ibid.
15. ibid.

the scheme operator or the ASC.[16] The Review also **recommends** that an applicant should be required first to obtain leave of the court by establishing a prima facie case that the scheme is insolvent.[17]

Termination by the operator

8.9 If the purpose for which a scheme has been set up has been accomplished or is no longer capable of being achieved, there should be a simple procedure for terminating the scheme without a meeting of investors. However, the interests of investors should be protected. The Review **recommends** that the operator should be permitted to notify investors and the ASC where either of these circumstances applies and advise that the scheme will be terminated in 28 days unless the operator receives a requisition from investors or the ASC for a meeting of investors to consider a resolution that the scheme not be terminated but that the constitution of the scheme be amended appropriately.[18] Any meeting should have to be held within two months after the day the operator receives the requisition. In the intervening period, the scheme should continue. If neither the ASC nor investors require a meeting to be called, the scheme operator should be able to terminate the scheme at the end of the 28 day period. The Review recommends elsewhere in this report that scheme operators should be under a statutory duty to prefer the interests of investors in the scheme over their own interests where these are not identical.[19] This duty will guard against abuse of this termination power, for example, where a scheme operator otherwise might terminate a scheme merely because it is not providing it with sufficient fees or other returns.

Offence to continue a terminated scheme

8.10 The Review **recommends** that it should be an offence for the scheme operator to continue, including by taking new contributions, a scheme that has been terminated, without a court order.

Rules governing winding up

Procedures

8.11 The legal form of a collective investment scheme (for example, partnership or trust) and the terms and conditions of its constituting document will affect the rules governing its winding up. The Review **recommends** that some matters which are common to the winding up of collective investment schemes in which the

16. Scheme operators and their directors may want to terminate a scheme, given the liability of scheme operators for scheme debts. For what constitutes an insolvent scheme, see para 8.13.
17. cf Corporations Law s 459P(2), (3) where the company itself and a creditor (other than a contingent or prospective creditor) of the company may apply for winding up without prior leave. In collective investments, creditors have remedies directly against the scheme operator. Given this, to require applicants for winding up of a collective investment scheme to obtain prior leave would not be oppressive.
18. For the investors' power to requisition a meeting see para 11.23. For the ASC's power to requisition a meeting see para 14.26.
19. See para 10.8.

scheme operator holds the scheme property should be included in the Corporations Law. These matters, based on various corporate winding up and voluntary administration provisions, include

- who can be the liquidator of a scheme (for example, the person must be a registered liquidator and independent of the scheme operator and must not be insolvent)[20]
- the appointment of a liquidator to a scheme should have the effect of removing the scheme operator and the liquidator should have all the powers the scheme operator had[21]
- persons dealing with the scheme liquidator should be entitled to assume that the liquidator is acting within power[22]
- certain types of enforcement action against property of the scheme[23] and transfers of rights in the scheme[24] should be void after the scheme is terminated
- the liquidator should be entitled to require certain assistance in winding the scheme up (for example, the liquidator should have a right to books of the scheme,[25] the directors and secretary of the scheme operator should be required to give a statement of affairs of the scheme[26] and officers of the scheme operator should be required to give other information that the liquidator reasonably requires[27])
- the liquidator should be required to report possible offences to the ASC[28]
- the liquidator's remuneration should be fixed by the creditors of the scheme or by the court[29]
- the court should have power to remove a scheme liquidator[30] and appoint a new liquidator to fill a vacancy arising from the removal or otherwise[31]
- property of the scheme should be distributed first in payment of liabilities of the scheme and then to investors.[32]

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20. cf Corporations Law s 448A, 448B, 448C, 448D (voluntary administration), 532 (winding up).
21. cf Corporations Law s 437C, 437D (voluntary administration), 474 (court winding up), 495(2) (members' voluntary winding up), 499(4) (creditors' voluntary winding up).
22. cf Corporations Law s 442F (voluntary administration), 505 (voluntary winding up).
23. Attachment, sequestration, distress or execution: cf Corporations Law s 440G (voluntary administration), 468(4) (court winding up), 500(1) (creditors' voluntary winding up), 570 (winding up generally).
24. cf Corporations Law s 468(1) (court winding up).
25. cf Corporations Law s 438B(1), 438C (voluntary administration), 530A(1), 530B (winding up).
26. cf Corporations Law s 438B(2) (voluntary administration), s 475(1) (court winding up).
27. cf Corporations Law 438B(3) (voluntary administration), s 475(2), (3) (court winding up), 530A(2) (windings up generally).
28. cf Corporations Law s 438D (voluntary administration), 533 (winding up).
29. cf Corporations Law s 449E (voluntary administration), 473(3)-(6) (court winding up), 495(1) (members' voluntary winding up), 499(3) (creditors' voluntary winding up).
30. cf Corporations Law s 449B (voluntary administration), 473(1) (court winding up), 503 (voluntary winding up).
31. cf Corporations Law s 449C(6), 449D (voluntary administration), 473(7) (court winding up), 495(3) (members' voluntary winding up), 502, 503 (creditors' voluntary winding up).
32. cf Corporations Law s 501 (voluntary winding up). Provisions for proofs of debt in the winding up of a collective investment scheme will be required. They can be based on the provisions in the Corporations Law and Regulations Pt 5.6. The Review's draft legislation does not include such provisions.

The Review **recommends** that, in addition, there should be a wide power for the court to give directions in relation to the winding up of a scheme. Directions given under this power would override the ordinary rules for winding up or any provision in the scheme's constitution.

Winding up expeditiously

8.12 There should be no unjustified delay in winding up the affairs of a collective investment scheme that has been terminated. The Review **recommends** that a registered liquidator should be appointed either by the court or the scheme operator[33] to a scheme that has been terminated to ensure that it is wound up expeditiously. The Review also **recommends** that the liquidator should be able to continue to carry on the business of the scheme if this is for the better winding up of the scheme.[34] This may be appropriate, for instance, to avoid assets being sold at a considerable discount because of the temporary condition of the market.

Voluntary administration of insolvent schemes

8.13 The voluntary administration procedure in the Corporations Law Pt 5.3A[35] permits the directors of an insolvent company to appoint an administrator to the company. The administrator, a professional insolvency practitioner, investigates the affairs of the company, formulates a proposal to deal with the insolvency and submits the proposal to creditors. The proposal may involve an arrangement with creditors, the winding up of the company or the ending of the administration. The Review considers that a similar procedure should be available for insolvent collective investment schemes. An alternative to this procedure would be the appointment of a judicial manager along the lines of the *Life Insurance Act 1945* (Cth).[36] The Review favours a procedure based on Corporations Law Part 5.3A. It **recommends** that the voluntary administration procedure in Pt 5.3A should be adapted to permit an administrator to be appointed to deal with the affairs of an insolvent scheme. A scheme would be taken to be insolvent if the operator of the scheme is unable to pay out of the property of the scheme all the debts incurred by the operator in respect of the scheme as and when they become due and payable.[37] The scheme operator should be able to appoint an administrator by resolution of its board of directors.[38] A temporary scheme operator should have the option of placing a scheme under administration if it considers that procedure to be the most

33. The court will appoint the liquidator if the scheme is terminated by order of the court. The scheme operator will appoint the liquidator in other cases.
34. cf Corporations Law s 1069(12) which permits continuation where the trustee and management company agree.
35. In force in June 1993: see footnote 9.
36. Pt III Div 8.
37. cf Corporations Law s 95A. The Review notes possible inadequacies in this exclusive definition of insolvency. The definition focuses on whether a company can pay its debts at a particular time and does not allow for the overall financial state of the company to be taken into account in determining insolvency. The Review's draft legislation reflects the current s 95A. The Review considers that any revised definition of insolvency in s 95A should apply equally to collective investment schemes.
38. cf Corporations Law s 436A.

effective way of dealing with the scheme's insolvency. A chargee of the whole, or substantially the whole, of the scheme's property should also be permitted to appoint an administrator.[39]

Implications of scheme operator becoming insolvent

8.14 Where a scheme operator is unable to pay its debts or comes under external insolvency administration (for example, by the appointment of a receiver to its property or by going into liquidation), a temporary scheme operator must be appointed.[40] In relation to trading trusts ALRC 45 recommended that

- the liquidator or administrator of an insolvent company acting as trustee of a trading trust should be able to administer the business or affairs of the company as trustee as well as the business or affairs of the company in its own right and should have power to deal with property held by the company on trust[41]
- any provision in a trust deed allowing for the removal of the company as trustee or the exercise of any power that allows for the removal of the company as trustee should have no effect but there should be an exception to permit a liquidator or administrator to cause the company to resign as trustee.[42]

Those recommendations are appropriate to trading trusts, but not to large collective investment schemes. There may be a significant conflict of interests between the liquidator or administrator of the scheme operator and the investors. For example, the liquidator or administrator might maintain, rather than wind up, the scheme primarily to enhance the value of the indemnity rights of the insolvent scheme operator. Also, one or more of the schemes operated by an insolvent scheme operator may be commercially viable and should be continued. In these circumstances, it may be inappropriate for a liquidator or administrator of an insolvent scheme operator to act as the new scheme operator. To require court approval of a temporary scheme operator would not be unduly expensive or time consuming. The court may, where appropriate, appoint the liquidator or administrator as the temporary scheme operator. To give this discretion to the court would protect against any real or apparent conflict of interest. The Review **recommends** that the liquidator of a scheme operator should not be the liquidator of the operator's schemes unless the court so orders.

39. cf Corporations Law s 436C.
40. See para 14.20.
41. ALRC 45 para 245. ALRC 45 recommended that the provisions relating to trading trusts apply, so far as relevant, to a company under administration: para 271.
42. ALRC 45 para 258.