
Related Party Dealings Out of Managed Investment Schemes: Four Quandaries Addressed

Tom Clarke*

The Federal Court's decision in Australian Securities and Investments Commission v Avestra Asset Management Ltd provided a rare opportunity for judicial guidance on the interpretation and application of the Pt 5C.7 framework governing related party dealings out of the scheme property of managed investment schemes (MISs). The judgment considered and clarified four issues with Pt 5C.7 that arose on the facts in that case: (i) Is a cross-investment into a related party's MIS caught by s 208(1)? (ii) Can the responsible entity (RE)'s acquisition of bare legal title in shares acquired by the scheme amount to a "financial benefit" to the RE? (iii) How does Pt 5C.7 apply to financial benefits given indirectly, through an interposed scheme that is unregistered? and (iv) Who are the related parties of entities (other than the RE itself) whose giving of financial benefits is caught by s 208(1)(a)?

In *Australian Securities and Investments Commission v Avestra Asset Management Ltd (Avestra)*,¹ the Federal Court made declarations and disqualification orders by consent against two directors of a funds management business, arising from several courses of related party dealings that were carried out through a number of registered and unregistered managed investment schemes (MISs) in Australia and offshore funds established in the Cayman Islands. In its reasons for judgment, the Court gave close consideration to a number of issues in the interpretation and application of Pt 5C.7 of the *Corporations Act 2001* (Cth) – which applies a modified version of the Ch 2E framework prohibiting related party dealings by public companies – for the first time.

Like the Ch 2E public company provisions, the Pt 5C.7 prohibition on giving financial benefits out of the scheme property of an MIS to the scheme's responsible entity (RE) or its related parties has rarely been litigated to judgment in the 20 years since it was first enacted in 1998. The cross-referenced drafting style of Pt 5C.7 not only makes the modified Ch 2E difficult to decipher for the non-specialist user; it also camouflages a number of drafting difficulties and errors, a number of which were exposed on the facts presented in *Avestra*. Given the breadth and complexity of the related party dealing prohibitions, the judicial guidance that has been provided in *Avestra* should be welcome to practitioners, and should be taken on board in considering any further legislative reform to the Ch 5C framework.

Parts I–III introduce the legislative background to the Pt 5C.7 regime, and give a brief survey of previous judicial authority on the public company and MIS related party dealing prohibitions. Part IV provides an overview of the related party dealing issues that were considered in *Avestra*, and Beach J's observations and reasoning in relation to each. In addition to the related party dealing questions, the judgment in *Avestra* also provides important observations in relation to a number of other key obligations of REs under Ch 5C, and of financial services licensees under s 912A, but which are beyond the scope of this article.²

* List G Barristers, Ninian Stephen Chambers, Melbourne; BA (Hons) LLB (Hons). The author appeared for ASIC in *Avestra*, together with Jonathon Moore QC, who stimulated much of this analysis. All opinions, errors and omissions are the author's own.

¹ *Australian Securities and Investments Commission v Avestra Asset Management Ltd (in liq)* (2017) 120 ACSR 247; [2017] FCA 497.

² See Pamela Hanrahan, "Conflicts of Duties in Statutory Contexts: Managed Investments, Superannuation and Financial Services" (Paper given at the NSW Supreme Court Annual Commercial and Corporate Law Conference, November 2017) <http://www.supremecourt.justice.nsw.gov.au/Documents/Publications/Corporate%20and%20Commercial%20Law%20Conference/2017/2017_Hanrahan.pdf>.



I. ADAPTING THE PUBLIC COMPANY PROHIBITION FOR MANAGED INVESTMENT SCHEMES: THE LEGISLATIVE BACKGROUND

The qualified prohibition on public companies giving financial benefits to their related parties was first enacted, as Pt 3.2A of the *Corporations Law*, in 1992.³ It was enacted in response to concerns that the pre-existing regulation of loans to directors had been too readily circumvented during the 1980s, by other varieties of related-party dealings to the detriment of unrelated shareholders and creditors.⁴ The basic structure of that regime has remained unchanged since it was first enacted: that is, a public company is prohibited from giving a “financial benefit” to its “related party”, unless it has obtained the formal approval of its shareholders, or unless a statutory exception applies. The main exception is that shareholder approval is not required for transactions that are made on terms that are no more favourable to the related party than would be reasonable if the public company and related party were dealing at arm’s length (the “arm’s length terms” exception).⁵

At around the same time, the Australian Law Reform Commission (ALRC) undertook a review of the regulatory framework for collective investment schemes, which were then governed by the “prescribed interest” provisions of the *Corporations Law*. The ALRC’s review was also prompted by financial excesses of the 1980s, in particular, investor losses that flowed from a series of property trust collapses.⁶ The ALRC criticised the prescribed interests regime broadly, including for the lack of transparency and accountability inherent in the mandated dual manager/trustee structure and the regime of prescribed covenants that were required to be included in each scheme’s constituent deed.⁷

As part of its proposed overhaul of the regulatory framework for collective investments, the ALRC recommended that the Pt 3.2A framework should be adapted to regulate transactions between scheme operators and their associates or related parties: namely, a general prohibition of related party dealings, subject to statutory exceptions or formal approval of the members of the scheme.⁸

Interestingly, the ALRC recommended that, where prohibited a related party dealing is made, *both* the scheme operator and other persons involved in the breach should be subject to civil penalty or criminal liability.⁹ However, the ALRC did not expressly address the fact that the Pt 3.2A regime excluded the public company itself from liability for giving a financial benefit to its related party,¹⁰ so that a fundamental architectural modification of the Pt 3.2A regime would be required in the collective investment scheme context, in order to hold both scheme operators and other persons involved in the related party transaction liable for any contravention. Yet, contrary to the ALRC’s recommendation, no such architectural modification was made, with the result that an RE does not itself commit a criminal or civil penalty offence by giving a prohibited financial benefit. That fundamental anomaly has remained entrenched in the related party dealing regime that now applies to registered schemes under Pt 5C.7.¹¹

The ALRC’s recommendations were otherwise substantially adopted in the *Managed Investments Act 1998* (Cth). Within the new Ch 5C of the *Corporations Law*, Pt 5C.7 was included to adapt and apply

³ By the *Corporate Law Reform Act 1992* (Cth), inserting the *Corporations Law*, Pt 3.2A ss 243A–243ZI.

⁴ For a discussion of the background, see Jon Webster, “Transactions Involving Public Companies and Their Related Parties” (1996) *AMPLA Yearbook* 407.

⁵ *Corporations Act 2001* (Cth) s 210; originally enacted as *Corporations Law*, s 243N.

⁶ Australian Law Reform Commission, *Collective Investments: Other People’s Money*, Report No 65 (1993) Vol 1, [1.5]. See also *Westfield Management Ltd v AMP Capital Property Nominees Ltd* (2012) 247 CLR 129, 135–136 [10]–[11]; [2012] HCA 54.

⁷ Australian Law Reform Commission, n 6, summary, [8]–[9].

⁸ Australian Law Reform Commission, n 6, [10.24]–[10.25]. First inserted as Pt 3.2A, the related party dealing provisions for public companies were subsequently relocated and renumbered as *Corporations Law*, Ch 2E.

⁹ Australian Law Reform Commission, n 6, [10.25].

¹⁰ *Corporations Law*, s 243ZE(4); now provided for by *Corporations Act 2001* (Cth) s 209(1)(b).

¹¹ This anomaly has been remarked upon in Pamela Hanrahan, CCH, *Managed Investments Law and Practice*, ¶54-700, and in CAMAC, “The Establishment and Operation of Managed Investment Schemes” (Discussion Paper, March 2014) 97.

the public company related party dealing provisions to the MIS context. The structure of Pt 5C.7 has remained unaltered since, in that:

- (1) s 601LA provides that Ch 2E applies to registered schemes with the modifications set out in Pt 5C.7;
- (2) s 601LB sets out a modified objects provision, clarifying that the object of Pt 5C.7 is to protect the scheme property and the interests of members in the scheme property;
- (3) s 601LC replaces, in full, the primary prohibition in s 208(1). As originally enacted, the modified prohibition was quite concise. It provided that, subject to the relevant statutory exceptions or to formal approval of the members:¹²

The responsible entity of a registered scheme must not give a financial benefit to itself, or to a related party:

- (a) out of the scheme property; or
 - (b) that could diminish or endanger the scheme property.
- (4) s 601LD omits certain of the statutory exceptions for public company related party transactions that are inapplicable to registered schemes; and
 - (5) s 601LA(a)–(f) makes global textual amendments to adapt the Ch 2E provisions from the public company to the MIS setting, including that references to a public company are to be read as referring to the RE of a registered scheme.

Changes to both the public company and MIS provisions were then made by the *Corporate Law Economic Reform Program Act 1999* (Cth). Most relevantly, the central prohibition in s 601LC was amended to its current form, which covers a wider range of givers and recipients of financial benefits. Under the modified form of s 208(1) as it now applies, unless a statutory exception applies or formal member approval is obtained, the following transactions are prohibited:

- (1) the benefit is given by:
 - (a) the RE of a registered scheme;
 - (b) an entity that the RE controls; or
 - (c) an agent of, or person engaged by, the RE
- (2) the benefit either:
 - (a) is given out of the scheme property; or
 - (b) could endanger the scheme property
- (3) the benefit is given to:
 - (a) the person who gives the financial benefit¹³ or a related party; or
 - (b) another person referred to in para (1) or a related party of that person.

As will be seen in Part IV D, this broadening of the classes of givers and recipients of financial benefits produced a misalignment of the global textual amendments that were originally made in the *Managed Investments Act* to adapt the public company provisions to the MIS setting.

To complete the legislative history, in 2001, the Turnbull review of the *Managed Investments Act* commented on the related party dealing provisions but did not make any recommendations.¹⁴ In his final report, Turnbull endorsed, as “warrant[ing] further examination”, a submission made by the Law Council of Australia that:¹⁵

Part 5C.7 attempts, by modification of certain provisions, to apply the related party transaction rules in Chapter 2E of the *Corporations Act* to registered schemes. It is not clear that it is appropriate (given the differences between schemes and companies, and the legal bases on which they operate) for self-dealing by a responsible entity to be regulated on this basis. Further, applying a modified Chapter 2E

¹² *Corporations Law*, s 601LC, as enacted in the *Managed Investments Act 1998* (Cth).

¹³ *Australian Securities and Investments Commission v Avestra Asset Management Ltd (in liq)* (2017) 120 ACSR 247, [166]; [2017] FCA 497.

¹⁴ Malcolm Turnbull, *Review of the Managed Investments Act 1998*, Final Report (December 2001) 99–101.

¹⁵ Law Council of Australia, *Submission to Review of the Managed Investments Act 1998*, 25 September 2001, 3.

makes the requirements complex and difficult to administer. Finally, the Committee believes there are significant drafting problems with Part 5C.7 that produce legal uncertainty and impact adversely on member protection.

The Law Council's criticisms of the cross-referenced adaptation of Ch 2E remain entirely apposite. Interpreting and applying the modified Pt 5C.7 regime to a number of common transaction scenarios is far from straightforward.¹⁶

II. THE INTENDED BROAD SCOPE OF THE RELATED PARTY DEALING PROVISIONS

The key concepts, common to both the public company provisions and the MIS provisions, are: what is a "financial benefit", and who is a "related party". Since their introduction in 1992, the consistent statutory intention has been that the provisions should operate broadly and non-formalistically, so as to minimise the scope for evasion through complex or contrived transaction structures.

The s 228 definition of "related party" is framed around the s 50AA concept of "control". Thus, an entity that controls an RE, an entity under common control with the RE (but not a subsidiary of the RE), and an entity that acts in concert with the RE, are all related parties of the RE. So too are the directors of the RE, the directors of, or persons making up, an entity that controls the RE, and each of their spouses, parents and children, and any entity controlled by their spouses, parents and children. Further, any entity that was a related party within the previous 6 months, or which is reasonably likely to become a related party of the RE at any time in the future, is also deemed to be a related party.

Section 229 then defines "financial benefit". Subsections (1) and (2), which apply in identical terms to both public companies and REs, make clear beyond any doubt that the concept is to be given a very broad interpretation:

- (1) In determining whether a financial benefit is given for the purposes of this Chapter:
 - (a) give a broad interpretation to financial benefits being given, even if criminal or civil penalties may be involved; and
 - (b) the economic and commercial substance of conduct is to prevail over its legal form; and
 - (c) disregard any consideration that is or may be given for the benefit, even if the consideration is adequate.
- (2) *Giving a financial benefit* includes the following:
 - (a) giving a financial benefit indirectly, for example, through 1 or more interposed entities;
 - (b) giving a financial benefit by making an informal agreement, oral agreement or an agreement that has no binding force;
 - (c) giving a financial benefit that does not involve paying money (for example by conferring a financial advantage).

Section 229(3) then gives six non-exhaustive examples of kinds of transactions that fall within the scope of the broad definition. Ford, Austin and Ramsay have long noted that the very broad terms of s 229, and the number and nature of the specific examples, make it hard to see what limiting effect the word "financial" might have.¹⁷ As Santow J emphasised in *Australian Securities and Investments Commission v Adler*, it is clear that "financial benefit" is to be given "the broadest of interpretation".¹⁸

The legislative intention favouring a broad interpretation could not be clearer. Yet the issues considered below demonstrate that there must be limits to the breadth of these concepts, particularly that of "financial benefit". Indeed, despite the express exhortation to "give a broad interpretation", it becomes clear that the true scope of the concept must, at least in some instances, be narrower than the ordinary meaning of the Act's defined expressions.

¹⁶ Helpfully, the reasons for judgment published on AustLII append a redline mark-up of the Ch 2E provisions, as modified by Pt 5C.7: *Australian Securities and Investments Commission v Avestra Asset Management Ltd (in liq)* (2017) 120 ACSR 247; [2017] FCA 497.

¹⁷ Robert Austin and Ian Ramsay, *Ford, Austin & Ramsay's Principles of Corporations Law* (LexisNexis online) [9.490]. The same observation in *Ford* was quoted by Annette Donselaar, "Are the Objects Stated in s 243A of the Corporations Law Achieved in Part 3.2A?" (1996) 3 *Deakin Law Review* 23.

¹⁸ *Australian Securities and Investments Commission v Adler* (2002) 168 FLR 253, [181]; [2002] NSWSC 171.

III. PREVIOUS JUDICIAL CONSIDERATION OF THE RELATED PARTY DEALING PROVISIONS

Since they commenced in 1994 and 1998, both the public company and MIS provisions have only rarely been litigated to judgment. Four main reasons for this are (i) the broad applicability of the “arm’s length terms” exception, (ii) the complexity of applying the principles to “real world” transactions (particularly the MIS provisions), (iii) uncertainty and lack of clarity about the true ambit of the prohibition, and (iv) uncertainty about whether, despite ss 103 and 209(1)(a), the court retains the ability to refuse to enforce a related party contract made without shareholder approval on grounds of public policy and illegality.¹⁹

Of the decided cases under the public company provisions, the first key authority is *Adler*, in which an HIH subsidiary paid \$10 million into a unit trust, which the unit trust then used to purchase shares in HIH itself. Santow J held that this payment conferred financial benefits on related parties of HIH, and so contravened s 208. Santow J gave robust effect to the broad definition of “financial benefit” in answer to the defendants’ technical arguments that no financial benefit had been conferred.²⁰ *Australian Securities and Investments Commission v Australian Investors Forum Pty Ltd (No 2)* is the leading authority on the s 210 “arm’s length terms” defence. Palmer J acknowledged that reasonable minds might differ on what would be within the realm of “reasonable” outcomes if a transaction had been negotiated at arm’s length, but that it is ultimately a matter to be determined by reference to expert evidence and/or the court’s own consideration of common sense and obvious commercial prudence.²¹ In *Orrong Strategies Pty Ltd v Village Roadshow Ltd*, Habersberger J followed the *Australian Investors Forum* test in examining a consultancy contract between Village Roadshow and a director of a related company, before concluding that the contract was not made on reasonable arm’s length terms.²²

The first judgment applying the MIS provisions did not appear until 2013 when, in *Australian Securities and Investments Commission v Australian Property Custodian Holdings Ltd (No 3)*, Murphy J held that a listing fee that was paid to the RE upon the MIS becoming listed on the ASX, was not authorised by a valid constitutional amendment, and so contravened the modified form of s 208.²³ In *Agricultural Land Management Ltd v Jackson (No 2)*, Edelman J upheld an admitted breach of s 208, arising from a sale of scheme property by the RE to a related party.²⁴ Finally, in *Australian Securities and Investments Commission v Managed Investments Ltd (No 9)*, payments made by the RE of a large retail scheme to its related parties were held to have been made in contravention of s 208(1).²⁵

¹⁹ See, eg, *Winpar Holdings Ltd v Goldfields Kalgoorlie Ltd* (2001) 166 FLR 144, [47]–[61]; [2001] NSWCA 427 (a court has no power to invalidate a prohibited reduction of capital, once made); *Orrong Strategies Pty Ltd v Village Roadshow Ltd* (2007) 207 FLR 245, 424–427 [775]–[785]; [2007] VSC 1 (recognising a residual ability to decline enforcement); *Re Summit Resources (Aust) Pty Ltd* (2012) 42 WAR 401, [67]–[79]; [2012] WASC 125 (noting, but not resolving, tension between *Winpar Holdings* and *Orrong Strategies*); *Mutual Holdings Pty Ltd v Shepard* (2015) 303 FLR 205; [2015] WASC 412 (preferring *Winpar Holdings*).

²⁰ *Australian Securities and Investments Commission v Adler* (2002) 168 FLR 253, [171]–[183]; [2002] NSWSC 171.

²¹ *Australian Securities and Investments Commission v Australian Investors Forum Pty Ltd (No 2)* (2005) 53 ACSR 305 [454]–[458]; [2005] NSWSC 267.

²² *Orrong Strategies Pty Ltd v Village Roadshow Ltd* (2007) 207 FLR 245, [716]–[774]; [2007] VSC 1.

²³ *Australian Securities and Investments Commission v Australian Property Custodian Holdings Ltd (No 3)* (2013) 31 ACLC 13-073, [684]–[700]; [2013] FCA 1342. The directors’ accessory contraventions were overturned on appeal, on the basis that they had a genuine belief in the validity of the constitutional amendment, and so were not “involved” in APCH’s contravention of s 208(1): *Lewski v Australian Securities and Investments Commission* (2016) 246 FCR 200, [303]–[325]; [2016] FCAFC 96. The trial judge’s finding that APCH had contravened s 208(1) by paying the listing fee was not expressly disturbed in that decision, or in *Lewski v Australian Securities and Investments Commission (No 2)* (2017) 352 ALR 64; [2017] FCAFC 171. However, special leave to the High Court has been granted: the grounds of appeal go to whether the constitutional amendment authorising payment of the listing fee had been validly made: *Australian Securities and Investments Commission v Lewski* [2018] HCATrans 91. If the constitutional amendment was validly made, then s 208(3) (as modified by s 601LC) would exempt both APCH and its directors from liability for contravention of s 208.

²⁴ *Agricultural Land Management Ltd v Jackson (No 2)* (2014) 48 WAR 1, [223]–[226]; [2014] WASC 102.

²⁵ *Australian Securities and Investments Commission v Managed Investments Ltd (No 9)* (2016) 308 FLR 216, [149], [332]–[334], [717]–[734], [759]; [2016] QSC 109.

Those previous decisions under the MIS provisions each addressed one or two isolated related party transactions. None of them had needed to grapple with any complications arising out of the way in which the public company provisions had been adapted in Pt 5C.7 to apply to MISs. That opportunity arose with the numerous permutations of related party transactions conducted through registered and unregistered schemes that were the subject of *Avestra*.

IV. AUSTRALIAN SECURITIES AND INVESTMENTS COMMISSION V AVESTRA ASSET MANAGEMENT LTD: TECHNICAL ISSUES ADDRESSED IN THE PT 5C.7 MIS FRAMEWORK

Avestra had originally been the RE of one registered scheme and the trustee of a number of unregistered schemes, which operated as unit trusts. Its contravening conduct began in 2013, when it invested several million dollars of scheme and trust property of those schemes to acquire a majority interest in Excelsa Ltd (later renamed AG Financial Ltd (AG Financial)), which was a ASX-listed fund manager and stockbroker. In essence, Avestra's directors sought to achieve a merger of the Avestra and AG Financial groups, and thereby to achieve back-door listing. In making those acquisitions of shares in AG Financial through its various schemes, Avestra did not disclose its own relevant interests in the voting shares of AG Financial, and disregarded the takeover prohibitions under Pt 6.1. Once it had acquired effective control of AG Financial, Avestra procured its own appointment as RE of four AG Financial-managed registered schemes. Avestra then proceeded to engage in further courses of related party transactions through those schemes, which resulted in:

- (1) Avestra advancing unsecured loans to itself from an unregistered scheme (the Avestra Credit Fund), in which scheme property of its registered schemes was invested (both directly and indirectly); and
- (2) the assets and unit-holdings of another of Avestra's unregistered schemes, the Canton Fund, being transferred to a Cayman Islands investment trust, whose operator was part-owned by, and had a common director with, Avestra.

To summarise briefly, the facts in *Avestra* presented an unprecedented set of permutations and combinations of MIS related-party transactions, none of which had been formally approved by members of the relevant schemes. The director defendants did not advance the s 210 "arm's length terms" defence in relation to any of the impugned transactions.

The case thus presented a series of case studies that exposed a number of novel issues about how the MIS related party dealing provisions applied to a variety of transactions. In granting the declarations that the Australian Securities and Investments Commission (ASIC) and the defendant directors proposed by consent, Beach J gave reasons that addressed, and shed light on, four discrete questions about the operation of Pt 5C.7.

A. Is a Cross-investment into a Related Party's Managed Investment Scheme a "Financial Benefit" to the Related Party?

In a number of transactions, ASIC alleged that s 208(1) was contravened either where:

- (1) Avestra, as RE of a registered scheme, invested scheme property in an unregistered scheme of which Avestra was also the trustee; or
- (2) Bridge Global Securities (a related party of Avestra), as investment manager of certain other registered schemes (whose RE was independent, and unrelated to Avestra), invested scheme property in schemes of which Avestra was RE or trustee.

In both cases, as RE or trustee of the destination scheme, Avestra obtained only the legal title to the funds invested: the beneficial interest in the invested funds accrued to the members of the recipient fund as a whole.²⁶ Did Avestra nonetheless obtain a "financial benefit", within the meaning of s 229?

²⁶ But a beneficial interest would accrue to the RE if it held units in the destination scheme, as s 601FG(1) permits.

Beach J accepted that there are two ways in the trustee of the destination scheme can be said to give rise to a financial benefit. First, by increasing the size of the funds under management of the trustee of the destination fund – a fact which the trustee might use to promote itself. Second, by enabling the same party to earn multiple fees from the cross-invested funds. As a matter of commercial and economic substance, it was accepted that the RE or trustee of a destination scheme incurs a financial benefit from the mere investment of funds into the scheme.²⁷

The consequence of this holding is that every investment by a registered scheme into a fund whose RE or trustee is a related party of either the RE, or investment manager, of the first registered scheme is *prima facie* a related party transaction, for which the approval of the members of the source scheme must be obtained, unless any of the exceptions applies. This ought not be a surprising outcome: in 1993, the ALRC expressly contemplated that the Ch 2E prohibitions should apply where scheme property of a registered scheme is invested in another scheme operated by a related party.²⁸ However, an unresolved question remains as to whether and how the s 210 arm's length terms exception might apply in relation to such an investment.

B. Is the Acquisition of Legal Title to Shares a “Financial Benefit”?

Avestra embarked on acquiring a majority shareholding in AG Financial Ltd by a set of secondary acquisitions from AG Financial's outgoing CEO, totalling 22% of the issued shares in AG Financial. The purchases were made through a registered scheme and two unregistered schemes of which Avestra was RE or trustee. Avestra caused substantial shareholder notices to be filed, which disclosed only the discrete interests held by the two schemes whose respective shareholdings were greater than 5%, but did not disclose that Avestra itself had acquired a relevant interest in AG Financial of greater than 20%, in contravention of the 20% takeover threshold.²⁹ Thereafter, Avestra increased its shareholding in AG Financial from 22% to 56% principally through subscribing to a placement, rights issue and shortfall allocation. Avestra committed further disclosure and takeover contraventions in making those further primary acquisitions.

ASIC alleged that the initial secondary acquisitions of shares in AG Financial made (directly or indirectly) using scheme property of a registered scheme were related party transactions that required shareholder approval under s 208(1). The beneficial interest in the purchased shares – encompassing the rights to any dividend stream, capital gain or proceeds of a winding up – was of course vested in the members of the purchaser schemes: Avestra acquired only legal title to the shares.

Did Avestra's acquisition of legal title to those shares, in a listed company of which Avestra subsequently acquired a majority shareholding, result in Avestra obtaining a “financial benefit”?

Beach J held that, on the agreed facts, Avestra obtained a financial benefit in two ways by acquiring legal title to the shares. First, although there was no direct evidence of Avestra having exercised its voting power in the purchased shares, the initial purchases enabled Avestra to procure AG Financial to appoint Bridge Global Securities (a related party of Avestra) as investment sub-manager of registered schemes of which an AG Financial subsidiary had hitherto been the investment manager, and to procure AG Financial to enter into an agreement to acquire the entire shareholding of Avestra Capital Ltd (another related party of Avestra). Those outcomes were held to be commercially valuable benefits that Avestra realised as a result of the initial share purchases.³⁰ Second, Avestra also achieved a financial benefit by the fact that

²⁷ *Australian Securities and Investments Commission v Avestra Asset Management Ltd (in liq)* (2017) 120 ACSR 247, [150]–[153]; [2017] FCA 497, following *Australian Securities and Investments Commission v Adler* (2002) 168 FLR 253, [182]; [2002] NSWSC 171.

²⁸ Australian Law Reform Commission, n 6, [10.25].

²⁹ Avestra thus committed contraventions of s 671B(1) and s 606(1)(c)(i), of which it had been criminally convicted in a separate prosecution: see *Australian Securities and Investments Commission v Avestra Asset Management Ltd (in liq)* (2017) 120 ACSR 247, [98]; [2017] FCA 497.

³⁰ *Australian Securities and Investments Commission v Avestra Asset Management Ltd (in liq)* (2017) 120 ACSR 247, [156]; [2017] FCA 497.

the initial 22% purchase, made through three separate schemes, facilitated Avestra's avoidance of the 20% takeover prohibition.³¹ That recognition that a commercial benefit may arise through evasion of an statutory prohibition is reminiscent of the purchase of HIH shares that was held in *Adler* to have been made in breach of s 208(1): in that case, the acquisition of shares through a unit trust (of which an HIH subsidiary was sole unit-holder) disguised a prohibited acquisition of shares by the subsidiary in its parent.³²

Thus, the financial benefit identified from these purchases of shares in *Avestra* arose from the broader commercial circumstances in which those acquisitions occurred. But two important further questions arise, relating to the everyday situation where a registered scheme invests in shares or other like securities.

First, when an RE acquires shares as trustee for the scheme members, it is usually accorded power (through the scheme constitution) to vote on the shares in its absolute discretion.³³ Conceivably, the power to exercise voting rights in respect of the shares might be characterised as amounting to a financial benefit to the RE in every case. Of course, however broad its constitutional powers, the RE is required to exercise those powers in the best interests of members (in priority to the RE's own interests) and with the care and diligence of a reasonable RE.³⁴ This suggests a qualification: that the RE's acquisition of voting rights in shares that it purchases on behalf of a scheme may give rise to a financial benefit to the RE only where the shares are acquired with the intention that the RE will, or where the RE does in fact, exercise its voting power in its own commercial interests, in contravention of the duties that the RE owes under s 601FC(1).

Second, and more dramatically, reading the definition of "financial benefit" together with a literal application of the definition of "property" in s 9 of the *Corporations Act 2001* would lead to an obviously over-broad result. Section 229(3)(a), as modified, specifies that giving or providing "property" to the RE amounts to the giving of a financial benefit. "Property" is defined as encompassing "any legal or equitable estate or interest ... in real or personal property of any description". An RE's acquisition of any shares on behalf of a registered scheme results involves the RE expending scheme property so that the RE itself obtains the legal interest in shares. Thus, a literal application of the definition of "property" would bring about the result that every acquisition of shares by an RE on behalf of a registered scheme involves the RE giving a "financial benefit" to itself, and would thus need to be approved by scheme members if none of the exceptions applies, on pain of any person involved in the share acquisition becoming subject to civil penalties.³⁵ That would be an unworkable and manifestly absurd outcome, which might suffice to satisfy a court that the definition of "property" ought not be applied with the full breadth of its literal meaning in conjunction with s 229(3)(a).³⁶

It follows that the mere fact that the RE obtains legal title to the shares ought not be sufficient to give rise to a "financial benefit" to the RE. But, as the facts of *Avestra* establish, it is possible for an RE to exercise voting rights, or to use some other influence deriving from its legal ownership of shares, to bring about commercial benefits to itself, either in disregard of the best interests of scheme members or to their detriment, in ways that ought properly be subject to the s 208(1) prohibition. A bright line between share purchases that do, and do not, confer a "financial benefit" on the RE might be difficult to locate with certainty.

³¹ *Australian Securities and Investments Commission v Avestra Asset Management Ltd (in liq)* (2017) 120 ACSR 247, [157]; [2017] FCA 497.

³² *Australian Securities and Investments Commission v Adler* (2002) 168 FLR 253, [176]–[182]; [2002] NSWSC 171.

³³ The right to vote on purchased shares may be conferred explicitly, or by a provision empowering the trustee to exercise any rights in relation to the shares, or more broadly by a provision that empowers the trustee to exercise all powers in respect of the shares as if it were an absolute owner and acting in its personal capacity.

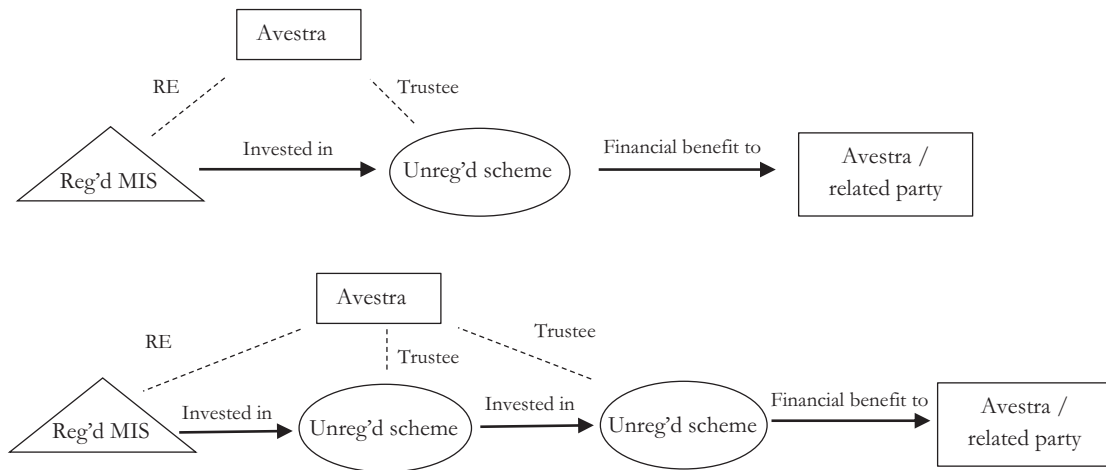
³⁴ *Corporations Act 2001* (Cth) s 601FC(1)(b), (c). See generally *Wellington Capital Ltd v Australian Securities and Investments Commission* (2014) 254 CLR 288, [11], [34]; [2014] HCA 43.

³⁵ *Corporations Act 2001* (Cth) s 209(1).

³⁶ See, eg, *Cooper Brookes (Wollongong) Pty Ltd v Commissioner of Taxation* (1981) 147 CLR 297.

C. Giving a Financial Benefit Through an Interposed Scheme

In a number of instances, Avestra gave financial benefits to itself or to its related parties out of the trust property of one of its unregistered schemes in which its registered schemes were invested, either directly or indirectly.



The question for the Court was: where the financial benefit is paid from an unregistered scheme, in which a registered scheme is invested, is the financial benefit given “out of” scheme property of the registered scheme?

Beach J concluded that the answer was compelled by s 229(2)(a), which stipulates that “giving a financial benefit” includes giving a financial benefit “indirectly, for example, through 1 or more interposed entities”. That accords with the obvious policy that the broad and substantive approach mandated by s 229 was intended to prevent the requirement for member approval to be circumvented merely by “routing” the financial benefit via an interposed unregistered scheme.³⁷ That conclusion was fortified by the fact that Avestra was both RE of the registered scheme and trustee of the interposed unregistered schemes: therefore, the inescapable conclusion in this case was that Avestra was party to, or involved in, the giving of a financial benefit out of the interposed fund.³⁸

The same result may be reached by the established proposition that a unit-holder in a unit trust holds a fractional equitable interest in the trust assets as a whole.³⁹ On that approach, the scheme property of the registered scheme includes a fractional interest in the trust property of the interposed unit trust: as such, any payment out of the interposed unit trust also amounts to the giving of a financial benefit “out of” the scheme property of the registered scheme.

Again, the question arises how far this principle may be extended. It may be necessary that the benefit must be given out of the interposed scheme by the RE of the first scheme or one of its associates. If the trustee of the interposed scheme is wholly independent of, and is not appointed by, the RE of the first scheme, then the condition in s 208(1)(a) would not be satisfied. So, in practical terms, there may need to be a degree of connection between the first and interposed schemes. But, on the face of s 229(2)(a), it does not appear to be necessary that the giving of a benefit through the interposed scheme must be a deliberately structured transaction. And the requirement to obtain approval of the first scheme’s members might be triggered even where the two successive transactions occur a long time apart, or no

³⁷ *Australian Securities and Investments Commission v Avestra Asset Management Ltd (in liq)* (2017) 120 ACSR 247, [161]; [2017] FCA 497.

³⁸ *Australian Securities and Investments Commission v Avestra Asset Management Ltd (in liq)* (2017) 120 ACSR 247, [164]; [2017] FCA 497.

³⁹ *Charles v Commissioner of Taxation (Cth)* (1954) 90 CLR 598, 609; *Read v The Commonwealth* (1988) 167 CLR 57, 61–62.

matter how small the first scheme's interest in the interposed scheme is. If the broad and substantive reading of s 229(2)(a) were applied too rigidly, it is not difficult to see that impractical and uncommercial outcomes could result.

D. Who Are the “Related Parties” of a Non-RE Giver of a Financial Benefit?

Under the modified form of s 208, member approval may be required where a financial benefit is given out of scheme property:

- by the RE, an entity controlled by the RE, or by an agent of, or person appointed by the RE (the “giver” limb: s 208(1)(a));
- to any of those persons, or to a “related party” of any of those persons (the recipient limb: s 208(1)(c)).

“Related parties” are defined in s 228, which is modified for the MIS context by s 601LA(a). Section 601LA(a) requires that references to a “public company” be read as referring to the RE of a registered scheme. Modified in that way, s 228 then specifies which entities and persons are taken to be related parties *of an RE*. In terms, the modified form of s 228 does not purport to define who are the related parties of an RE-controlled entity, or of an agent or person appointed by the RE. So, on one hand, s 208(1)(c) expressly prohibits the giving of financial benefits to a related party of an RE-controlled entity, or of an agent or person appointed by the RE; while, on the other hand, s 228 does not expressly define who the related parties of those entities are.

Beach J observed that this definitional problem arose as a drafting oversight in the modified cross-referencing approach that has been used to adapt Ch 2E to the MIS context.⁴⁰ His Honour addressed the definitional problem by identifying three, and eliminating two, possible solutions. First, Beach J rejected the possibility that the failure of s 228 to define who are the “related parties” in s 228 an RE-controlled entity, or of an agent or person appointed by the RE, might mean that no contravention is committed by giving a financial benefit to a related party of those entities. That would defeat the clear intent of the modified form of s 208(1)(c), which is “a result that could only appeal to those afflicted with a sclerotic form of textualism”.⁴¹ Second, he considered and rejected the possibility that “related party” might fall to be interpreted and applied as a matter of the ordinary and natural meaning of that expression: the criterion “related” is too elastic and unclear to enable stakeholders to determine with confidence when the need for member approval is triggered under s 208.

In the result, Beach J remedied the drafting oversight in the modified form of s 228 by construing the definition purposively, as applying *mutatis mutandis* both to identify the related parties of an RE and the related parties of RE-controlled entities and of agents or persons appointed by an RE. As a matter of construction, that result could be achieved either by interpreting the provision remedially, in order to achieve the clear legislative purpose, or (if necessary) by reading in additional words to remedy the drafting error.⁴²

V. CONCLUSIONS

As the judgment in *Avestra* was for the making of declarations and disqualification orders by consent, the Court was not required to examine the arguments put forward as to the construction and application of Pt 5C.7 as rigorously as would have been required if liability for the contraventions had been contested.

⁴⁰ *Australian Securities and Investments Commission v Avestra Asset Management Ltd (in liq)* (2017) 120 ACSR 247, [178(b)]; [2017] FCA 497. As appears from the history sketched out in Part I of this article, the drafting misalignment occurred as a result of the more elaborate modified form of s 208 that was introduced by the *Corporate Law Economic Reform Program Act 1999* (Cth), after the enactment of the Pt 5C.7 in 1998.

⁴¹ *Australian Securities and Investments Commission v Avestra Asset Management Ltd (in liq)* (2017) 120 ACSR 247, [171]; [2017] FCA 497.

⁴² *Australian Securities and Investments Commission v Avestra Asset Management Ltd (in liq)* (2017) 120 ACSR 247, [174]–[179]; [2017] FCA 497.

Nonetheless, it provides important judicial confirmation that the related party dealing provisions are to be applied robustly, but commercially, in order to protect the interests of investors in registered MISs.

The Court's consideration of the four issues outlined above shows that the limits of the related party dealing prohibitions still remain to be clarified in a number of respects – in particular, as to an RE's acquisition of shares (and other securities) on behalf of the registered scheme, discussed in Part IV B. Insofar as it might be suggested that a literal application of the broad definitions of “financial benefit” and “property” would lead to a contravention of s 208(1) occurring even in circumstances where there is no risk to scheme property, or to members' investments in a scheme, then there may be room for REs, their related parties and their respective officers and employees to obtain relief from liability under ss 1317S and 1318. Yet that would be a singularly inadequate answer to difficulties that may be thrown up by inadequacies in the shorthand drafting of Pt 5C.7: it would not begin to address the difficulty and uncertainty that are created for those giving and receiving advice as to the Pt 5C.7 obligations.

The difficulties addressed in *Avestra*, and the further observations developed above, ought be taken into consideration by policymakers and drafters if and when the project of reviewing and overhauling the Ch 5C of MISs is revived and carried through to fruition.