Removing the RE – commentary on procedural steps

The table below summarises the procedure by which members of a registered scheme are able to remove the RE of the scheme. It does so by setting out each of the relevant provisions of the Act that need to be satisfied in order to achieve the removal of the RE, together with commentary on the impact of the recent, and more established, case law.

<table>
<thead>
<tr>
<th>Procedural step</th>
<th>Commentary</th>
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<tbody>
<tr>
<td>Right to convene meeting of members</td>
<td>In <em>Brisconnections Management v Australian Style Investments</em>(^{12}), the Victorian Supreme Court recently considered the limitations on members’ rights to convene meetings of members under Division 1 of Part 2G.4 of the Act. A member of the scheme (Australian Style Investments Pty Ltd (<em>ASI</em>)), had requisitioned a meeting to consider a number of resolutions, including resolutions to wind up the scheme, to modify the scheme’s constitution and to remove and replace the scheme’s RE. The RE argued that ASI’s request to convene a meeting under s252B(^{13}) of the Act was invalid, and the RE was therefore not required to call a meeting, on the basis that ASI had requisitioned the meeting for an improper purpose. The authorities establish that those who claim that the power to requisition a meeting has been exercised for an improper purpose must establish that the requisitionist does not really want the resolution passed at the meeting. Having considered the evidence before the court, Justice Robson held that the resolutions in question had been proposed by ASI in order to achieve the purpose for which they were designed. The fact that the resolutions may not have been pursued if some other event intervened, or that the resolutions may have enabled ASI to improve its bargaining power with the RE or other parties, did not mean the resolutions were not intended to achieve the purpose for which they were designed. Accordingly, it was held that ASI had validly exercised its power to requisition the meeting under s252B.</td>
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|                | In separate, but related, proceedings (*Macquarie Capital Advisers v Brisconnections*\(^{14}\)), the Supreme Court of Queensland considered whether members could call meetings, and propose and vote on resolutions, despite the effect such resolutions may have on the contractual rights of a third party. The proceedings were brought by Macquarie entities, which had contracted with the RE to provide bridging finance and underwriting services to the scheme. If passed, the resolutions proposed by ASI would have resulted in breaches of the RE’s contractual obligations under those arrangements, and Macquarie sought orders designed to prevent the putting of and voting on the resolutions. It was held that, other than in extraordinary cases (eg if the resolution cannot legally be carried into effect), members’ statutory rights to requisition meetings and to vote at such meetings were superior to, and therefore prevail over, the ‘quasi-proprietary’ contractual rights under the financing and underwriting agreements. Therefore, Justice Duttney refused to grant an injunction to prevent the meeting from going ahead. Importantly, in reaching this conclusion, Justice Duttney considered it relevant that the Macquarie parties would have adequate remedies available to them, by enforcing their contractual rights, in the event that the resolutions were passed. |

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13. Under s252B(1), the RE of a registered scheme must call and arrange to hold a meeting of the scheme’s members to consider and vote on a proposed special or extraordinary resolution on the request of members with at least five per cent of the votes that may be cast on the resolution or at least 100 members who are entitled to vote on the resolution.

| How many resolutions? | The recent cases have considered whether s601FM(1) requires two separate resolutions to be considered by members (ie one resolution relating to the RE’s removal and a separate resolution relating to the new RE’s appointment) or whether a single resolution is sufficient. This question has for some time been unclear because, although s601FM(1) refers to ‘resolutions’ in the plural, s601FM(2) (see below) and (by analogy) s252L(1B)(c), refer to the singular ‘resolution’.

Section 601FM(1): ‘… to consider and vote on a resolution that the current responsible entity should be removed and a resolution choosing a company to be the new responsible entity. The resolutions must be extraordinary resolutions if the scheme is not listed.’ |

The RE submitted that these resolutions did not satisfy the requirements of s601FM because a resolution to remove the RE will not work without a resolution to appoint a new RE (noting that a replacement RE was not identified in Resolution 7).

Nevertheless, Justice Robson held that Resolutions 6 and 7 were valid because ‘at the same meeting as the resolution to remove the RE is passed, the members could by ordinary resolution choose a new RE and thereby avoid the scheme having to be wound up by the RE’. It is doubtful whether this conclusion is in fact consistent with s601NE(1)(d) of the Act (see below).

In Brisconnections Management v Australian Style Investments, the following resolutions were proposed to be put to members:

Resolution 6: … that the Manager be removed as the responsible entity.

Resolution 7: In the event that the previous resolution is put to the meeting and passed, that a replacement responsible entity be appointed immediately after the meeting at which this resolution is passed and if a replacement is not then available or capable of appointment at that time then an application will be made to the Court in accordance with the Corporations Act to appoint a temporary responsible entity.

The RE submitted that these resolutions did not satisfy the requirements of s601FM because a resolution to remove the RE will not work without a resolution to appoint a new RE (noting that a replacement RE was not identified in Resolution 7).

Nevertheless, Justice Robson held that Resolutions 6 and 7 were valid because ‘at the same meeting as the resolution to remove the RE is passed, the members could by ordinary resolution choose a new RE and thereby avoid the scheme having to be wound up by the RE’. It is doubtful whether this conclusion is in fact consistent with s601NE(1)(d) of the Act (see below).

A few months later, in July 2009, the Federal Court of Australia considered the following resolution that was put to members in City Pacific v Bacon15:

That City Pacific Limited be removed as responsible entity of the City Pacific First Mortgage Fund in accordance with s601FM(1) of the Corporations Act and that Trilogy Funds Management Limited be appointed as responsible entity of the City Pacific First Mortgage Fund.

The resolution was passed and City Pacific sought a declaration that the passing of the resolution, and the subsequent alteration of the ASIC register, were ineffective to remove City Pacific as RE, on the basis that the resolution did not comply with s601FM. City Pacific argued that, on its proper construction, s601FM(1) requires that, in order to replace a RE, two distinct resolutions must be voted on separately at one meeting, and that the resolution that was put to members did not satisfy that requirement and was therefore void.

Justice Dowsett held that the resolution was consistent with s601FM(1) and had been validly passed. In particular, while Justice Dowsett accepted that s601FM(1) contemplates two resolutions, he did not consider that this requires members to vote separately on the removal and replacement resolutions.

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15. City Pacific Ltd (as the responsible entity for the City Pacific First Mortgage Fund) v Bacon (as agent for the ‘Requisitioning Members’) (No 2) [2009] FCA 772 (July 2009).
What type of resolution?
Section 601FM(1): ‘The resolutions must be extraordinary resolutions if the scheme is not listed.’

While the Act clearly specifies that the resolutions must be extraordinary resolutions (i.e., 50 per cent of total votes that may be cast) for unlisted schemes, until *MTM Funds Management v Cavalane*\(^{16}\) in 2000, it was unclear whether the resolutions for listed schemes needed to be extraordinary, special (i.e., 75 per cent of votes cast) or ordinary (i.e., 50 per cent of votes cast) resolutions. Justice Austin held that, in the case of a listed scheme, the resolutions must be ordinary resolutions. This was despite the fact that s252B (which relates to member requisitioned meetings, and is therefore linked to s601FM(1)) refers only to extraordinary and special resolutions. In Justice Austin’s view, s252B merely deals with the machinery for requisitioning the meeting. Justice Austin relied on the explanatory memorandum to the CLERP Bill (being the legislation that extended the takeover provisions to listed schemes) which made it clear that the legislative intention was to enable the RE of a listed scheme to be removed by simple majority and without any restrictions on who can vote (see s253E below).

This view was confirmed most recently in *Brisconnections Management v Australian Style Investments.*

Following *MTM Funds Management v Cavalane*, ASIC issued class order relief to clarify that the resolutions under s601FM(1) are ordinary resolutions (ASIC Class Order 01/1541).

Can the RE and its associates vote?
Section 253E: ‘The responsible entity of a registered scheme and its associates are not entitled to vote their interest on a resolution at a meeting of the scheme’s members if they have an interest in the resolution or matter other than as a member. However, if the scheme is listed, the responsible entity and its associates are entitled to vote their interest on resolutions to remove the responsible entity and choose a new responsible entity.’

The voting restriction in s253E gives rise to many issues. Two of the main issues that relate to replacing REs are discussed below.

The first issue is whether either or both of the resolutions under s601FM are resolutions in which the RE and its associates have ‘an interest…other than as a member’. In *Australian Olives v Livadaras*,\(^{17}\) it was assumed that the current RE ‘plainly’ had an interest other than as a member in the resolution concerning its removal as RE and its replacement with another RE. However, it is arguable that, although the current RE does have an interest in the removal resolution, it may not necessarily have an interest (other than as a member) in the replacement resolution. On that basis, if the resolutions are subject to separate votes, the existing RE may be prevented from voting on the first resolution but not the second resolution.

However, as discussed above, in *City Pacific v Bacon* it was held that the two resolutions do not need to be decided by separate votes. In coming to this view, Justice Dowsett considered whether the taking of only one vote would deprive the existing RE of its entitlement to vote on the second ‘replacement’ resolution. Justice Dowsett held that the form of the resolutions would not, of itself, have that effect because the RE would nevertheless be disqualified from voting on both the removal and replacement resolutions by virtue of s253E:

> ‘Their disenfranchisement was the consequence of the operation of s253E. The section suggests that a responsible entity has an interest in both its removal from that position and the choice of any replacement. The final sentence of s253E would otherwise be unnecessary. It is not difficult to identify reason[s] for treating the outgoing responsible entity as being interested in the choice of a replacement. Firstly, the removal and replacement are closely associated. The enthusiasm of the members for removal will almost certainly depend upon the availability of a suitable replacement, unless they were willing to wind up the scheme. In that case, one might expect them to proceed pursuant to s601NB rather than by way of application pursuant to s601FM(1). A responsible entity who did not wish to be removed might make it known that it was hostile to any proposed replacement. If it held sufficient votes to influence the outcome, such a disclosure might dissuade other members from voting for its removal. In those circumstances, and given that both matters must be resolved at the same meeting, one would be inclined to think that the responsible entity was sufficiently interested in the replacement to be disqualified from voting on that issue. Further, if the responsible entity were removed,


but no replacement was chosen, the outgoing responsible entity would be obliged to apply for the winding up of the scheme. As I have previously pointed out, it would normally be responsible for supervising that winding up. Thus it would, in effect, continue as responsible entity and would, presumably, derive a benefit from doing so. In that way, too, it would have an interest in the choice of a replacement. In the circumstances, I am not satisfied that City Pacific...would have been permitted to vote on a separate motion to choose a replacement RE.’.

The second issue relates to the term ‘associate’ and which definition of ‘associate’ applies for the purposes of s253E. In particular, it is unclear whether, for the purposes of s253E, the relevant ‘associate’ test is that contained in ss11 and 15 of the Act (on the one hand), or s12 of the Act (on the other hand). There is a view that the s12 test applies only where the reference to ‘associate’ relates to Chapters 6-6C of the Act (ie the takeover-related provisions) and, despite the seemingly broad language in s12, that test does not apply when determining the meaning of ‘associate’ for the purposes of s253E. Nevertheless, in Australian Olives v Livadaras it was assumed, without analysis or challenge, that the relevant ‘associate’ test for the purposes of s253E was the s12 test. It is important for this issue to be clarified by legislative reform or ASIC policy, as the adoption of one ‘associate’ test over another could have significant practical implications in particular situations.

New RE must be a public company that holds an AFSL

Section 601FK: ‘A company cannot be chosen or appointed as the responsible entity or temporary responsible entity of a registered scheme unless it meets the requirements of section 601FA.’

Section 601FA: ‘The responsible entity of a registered scheme must be a public company that holds an Australian financial services licence authorising it to operate a managed investment scheme.’

In Australian Olives v Stout\(^\text{18}\), it was confirmed that the requirement under s601FA that the RE must hold an Australian Financial Services Licence (AFSL) ‘authorising it to operate a managed investment scheme’ is not satisfied by holding an AFSL to conduct any managed investment scheme: ‘The section contemplates a licence authorising, according to its terms and conditions, a company to operate the managed investment scheme in question.’ In that case, the relevant AFSL authorised the proposed replacement RE to operate particular named schemes, but not the schemes in question. However, Justice Greenwood declined to make an order preventing the meeting to replace the RE from going ahead because he considered that questions regarding the prospective RE’s AFSL (and the need to vary it) were matters that the meeting could properly consider.

This raises a significant practical issue, which was discussed in Australian Olives v Stout (No 2)\(^\text{19}\), regarding the timing of a variation to an AFSL. Unless the prospective RE already holds an AFSL authorising it to operate schemes of the ‘kind’ in question (rather than particular named schemes) ASIC will not generally vary the AFSL to include additional named schemes for which the RE is seeking to be appointed as RE until members have passed a resolution appointing the new RE. Therefore, a resolution to appoint a new RE in these circumstances needs to be expressed to be conditional upon the necessary variation being made to its AFSL. As a practical matter, to minimise the risk of challenge, the prospective RE should, before the meeting, have at least obtained written confirmation from ASIC that it is prepared to make the necessary variation to the AFSL.

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New RE must consent

Section 601FM(2): ‘If the members vote to remove the responsible entity and, at the same meeting, choose a company to be the new responsible entity that consents, in writing, to becoming the scheme’s responsible entity:

(a) as soon as practicable and in any event within 2 business days after the resolution is passed, the current responsible entity must lodge a notice with ASIC asking it to alter the record of the scheme’s registration to name the chosen company as the scheme’s responsible entity; and

(b) if the current responsible entity does not lodge the notice required by paragraph (a), the company chosen by the members to be the new responsible entity may lodge that notice; and

(c) ASIC must comply with the notice when it is lodged.’

Section 601FM(3): ‘A person must not lodge a notice under subsection (2) unless the consent referred to in that subsection has been given before the notice is lodged.’

An unresolved issue, which has not yet been tested by the courts, relates to the timing of consent to become the scheme’s new RE. It is not clear whether the expression ‘that consents…to becoming the scheme’s responsible entity’ means the consent must have been given at or before the meeting, or whether it permits the consent to be given at a later date.21

Subsection 601FM(3) indicates that it may be possible for there to be a gap in time between the date of the meeting and the date on which the consent is given. On the other hand, the use of the expression ‘at the same meeting’ in both ss601FM(2) and 601NE(1)(d) (see below) suggest that the consent must be given at or before the meeting.

This issue is significant because, if the replacement RE is required to give its unconditional consent to becoming the scheme’s RE at or before the meeting, it will need to be committed to step into the shoes of the RE and (by virtue of the statutory novation provisions in ss601FS and 601FT of the Act) assume all of the liabilities and obligations of the former RE, at the date the resolution is put to members. The replacement RE will need to have completed its due diligence investigations and risk analysis before that time, and the existing RE would be under no statutory obligation to facilitate that process. Having said that, most REs are subject to continuous disclosure obligations under the Act and (where applicable) the ASX Listing Rules, and also have duties to act in the best interests of members of the scheme.

A recent trend has been for removal and replacement resolutions to be put to members on the basis that the change of RE will only become effective upon the satisfaction of certain conditions before a specified deadline (for example, one month after the meeting). Conditions could include completion of due diligence in relation to the scheme to the satisfaction of the proposed RE and/or the consent of third parties (such as financiers) to the change of RE. If a resolution drafted in this way is held to be effective, and is passed by members, s601FJ(1) (see below) would operate to preserve the ‘former’ RE’s status as RE until the ASIC register was updated (after the consent was given).

We think it is only a matter of time before the courts will be asked to consider the legitimacy of resolutions framed in such terms or, alternatively, before the ambiguity is cured by legislative reform or ASIC policy.

20. ASIC Form 5107.
21. For a detailed discussion of this issue, see Legg, M, Replacement of the responsible entity of a managed investment scheme by members (2009) 27 C&SLJ 299.
22. This note does not discuss the operation of ss601FS and 601FT.
**Scheme must be wound up if members vote to remove RE without appointing a new RE that consents**

Section 601NE(1)(d): ‘The responsible entity of a registered scheme must ensure that the scheme is wound up...if the members pass a resolution removing the responsible entity but do not, at the same meeting, pass a resolution choosing a company to be the new responsible entity that consents to becoming the scheme’s responsible entity.’

Although there is no case law dealing specifically with the circumstances in which the RE is required to take action to wind up the scheme in these circumstances, the section has been considered recently in the context of determining the form of resolutions required under s601FM (City Pacific v Bacon, discussed above). Prior to City Pacific v Bacon, when it had been considered prudent to structure the s601FM resolutions as two separate resolutions requiring two separate votes, the two resolutions were typically expressed to be inter-conditional in order to overcome s601NE(1)(d) being triggered. Following City Pacific v Bacon, it appears this is no longer necessary because two separate votes are not required. However, in our view, the most prudent approach would still be to have two separate resolutions, with two separate votes, which are expressed to be interconditional.

The section is also relevant in considering whether a replacement RE needs to have provided its consent at or before the meeting (see above). If the replacement RE is required to provide its consent at or before the meeting, and that consent has not been provided in circumstances where the removal and replacement resolutions are passed, the RE will technically be required to wind up the scheme.

**Alteration of ASIC register**

Section 601FJ(1): ‘Despite anything in this Division, the company named in ASIC’s record of registration as the responsible entity or temporary responsible entity of a registered scheme remains the scheme’s responsible entity until the record is altered to name another company as the scheme’s responsible entity or temporary responsible entity.’

In Huntley Management v Australian Olives (No 2)\(^2\)\(^3\), it was held that this section does not defeat the requirements of ss601FK-601FQ relating to a change of RE (see also s601FJ(2) below). In other words, the section does not overcome any ineffectiveness of the purported removal and replacement of an RE; rather, it assumes an effective change of RE and provides that the current RE remains the scheme’s RE until ASIC updates its register.

The court placed emphasis on the word ‘remains’ and held that the section assumes the existence of an otherwise effective change of RE in accordance with ss601FK-601FQ, and provides that, ‘despite’ this, the current RE remains the scheme’s RE until ASIC’s record is altered to name another company as RE. The court did not accept that a company that becomes named in ASIC’s record of registration as the RE of a scheme will, by virtue of that registration, be the ‘new RE’ (within the meaning of that expression in ss601FR, 601FS and 601FT) if the purported change of RE did not comply with ss601FK-601FQ: ‘A denial of effectiveness until registration or lodgement is not to be equated with a grant of effectiveness by reason of registration or lodgement.’

The court recognised that there is a risk that a person could rely on the ASIC register and deal with the company named in ASIC’s record as the RE, only to discover subsequently that that company was not the true RE. In those circumstances, the court held that the person would have the benefit of the prima facie evidence constituted by the register, which would have to be displaced by evidence, and would have a claim against the company named in the register for breach of an implied warranty that it was the RE.

In City Pacific v Bacon\(^2\)\(^4\), Justice Dowsett similarly noted that his ‘immediate perception’ was that s601FJ(2) qualifies the operation of s601FJ(1), ‘ensuring that a change in the register will be ineffective if it is based upon a notice asserting a change which was effected otherwise than in accordance with Division 2’.

\(^{23}\) Huntley Management Ltd v Australian Olives Ltd (No 2) [2009] FCA 686 (June 2009).

\(^{24}\) City Pacific Ltd (as the responsible entity for the City Pacific First Mortgage Fund) v Bacon (as agent for the ‘Requisitioning Members’) (No 2) [2009] FCA 772 (July 2009).
This section has given rise to two issues.

First, does s601FJ(2) mean that Division 2 of Part 5C.2 of the Act is an exclusive code for changing the RE, which overrides any provision in the scheme’s constitution relating to changing the RE?

In MTM Funds Management v Cavalane Holdings Pty Ltd [2000] NSWSC 922, Justice Austin held that the words ‘in accordance with this Division’ do not mean that Division 2 of Part 5C.2 of the Act is an exclusive code for changing the RE, which prevents any provision in the scheme’s constitution for removal of the RE from having any operative effect. Justice Austin held that, unless the relevant constitutional provision is in conflict with, and therefore not in accordance with, the statutory provisions, it should be allowed to operate.

Secondly, there is a question about the meaning of ‘in accordance with this Division’ and the circumstances in which a change of RE will be found to be ineffective under this section.

In City Pacific v Bacon it was held that a resolution under s601FM(1) will not be ineffective by virtue of s601FJ(2), provided it complies substantially with the requirements of Division 2 of Part 5C.2. Justice Dowsett held that, even if his construction of s601FM(1) were wrong, and two separate votes were required, the resolutions would have complied substantially with the requirements of the Act and would not have been invalidated by virtue of s601FJ(2).