

Managed investment schemes

David Smith reports on *ASIC v Lewski* [2018] HCA 63

The High Court has held unanimously that directors of the responsible entity of a managed investment scheme breached their duties under the *Corporations Act 2001* (Cth) (Act) in circumstances where the directors resolved to amend the constitution of the scheme, resulting in substantial new fees being payable to the responsible entity without any corresponding benefit to members. The case is of interest because the conduct impugned was not the passing of the amendment resolution, which was time-barred, but a subsequent resolution authorising the lodgement of the amended constitution.

Background

In June 2006, Australian Property Custodian Holdings Ltd (APCHL), the responsible entity of a managed investment scheme, was taking steps towards a listing of the scheme on the ASX within the next 12 to 18 months. A resolution was passed on 19 July 2006 to amend the constitution of the scheme to confer very substantial new fees in favour of APCHL in the event of a listing, without any corresponding benefit to the members of the scheme (Amendment Resolution). The Amendment Resolution was not impugned in the proceeding because it was time-barred.

On 22 August 2006, a further resolution was passed to give effect to the Amendment Resolution by resolving to lodge the amended constitution with ASIC (Lodgement Resolution). The Lodgement Resolution was not time-barred. The central issue was whether the responsible entity and the directors had contravened the Act by resolving to lodge the amended constitution with ASIC and by later acts effecting the payment of the increased fees.

It was held at first instance that APCHL's directors had contravened various provisions of the Act. The Full Federal Court held that any breach of duty involved in the Amendment Resolution did not taint the Lodgement Resolution or subsequent acts by which the directors, acting honestly, merely gave effect to the amended constitution.



High Court decision

The High Court (Kiefel CJ, Bell, Gageler, Keane and Edelman JJ) unanimously allowed ASIC's appeal. The first argument addressed by the High Court arose from a notice of contention filed by the directors concerning s 601GC of the Act. That section provides that an amendment to the constitution of a responsible entity can be approved by the responsible entity without a special resolution of members where the responsible entity reasonably believes the amendment '...will not adversely affect members' rights'. The directors argued that the members had no 'right' under s 601GC to the due administration of the scheme. The Court rejected this argument on the basis of definitions in the Act which equated 'interests' with 'rights' and, where 'interest' has a '...broad, general meaning' (at [50]), that includes the due administration of the scheme. The Court said further that a narrow construction of 'rights' would be contrary to the purpose of s 601GC which is to protect the members of schemes (at [52]).

The first ground of appeal concerned the Full Court's view that the Amendment Resolution had 'interim validity', the effect being that the Amendment Resolution was deemed valid until it was set aside, even though it was invalid. Under this view, the Lodgement Resolution merely gave effect to the constitution as amended pursuant to the Amendment Resolution. The High Court held that there was '...no textual basis for interpreting s 601GC as not invalidating a noncompliant amendment, still less as conferring some qualified interim validity upon it' (at [59]). The Court further observed that

'interim validity' would cut across provisions in the Act that exonerate directors' breaches of duty and presume validity only for procedural irregularities (e.g. ss 1318 and 1322), and that such a concept '...has never been suggested to apply to unauthorised amendments to the constitutions of corporations' (at [62]).

The second appeal ground concerned the Full Court's conclusion that any breach of duty was 'spent' after the Amendment Resolution and that subsequent acts and resolutions were not tainted by any breaches involved in the passing of the Amendment Resolution. The High Court held that resolutions and other acts giving effect to the Amendment Resolution were not '... mere administrative task[s]' and that the Amendment Resolution '...even if valid, would have remained inchoate' and required further acts to give it legal and practical effect (at [66] to [67]). The High Court then considered the directors' duties of care, skill, diligence, loyalty and improper use of position, and duties to act in accordance with the constitution and the Act. It held that all these duties had been breached (at [68] to [78]).

The final matter considered by the High Court involved s 208(1) of the Act, which requires member approval where a responsible entity wishes to confer benefits on a related party. Section 208(3) provides that member approval is not required where the responsible entity is paying itself fees as provided for in its constitution. ASIC alleged that the directors were knowingly involved (under s 79(c) of the Act) in contraventions of s 208(1) relating to the payment of fees to a company associated with Mr Lewski. The issue was whether ASIC had to prove that the directors knew that the payment was not authorised by the constitution. The Court held that ASIC did need to prove the directors knew that the constitution did not authorise the payment and it was common ground that ASIC could not do so (at [87]).