

Report for Senate Select Committee-Managed Investment Schemes

Schemes Chairman-Mr Bill Heffernan

Short Paper on the Specific Impact on the Availability and Efficient Use of Capital-MIS Projects

The Great Southern Plantations (*Scheme Promoter Company*) experience incorporating responsibility issues, a remedial action proposal and a suggested better way of planning and implementing future MIS government supported proposals.

History

1. We have seen successive Federal Governments actively support tree planting in Australia. My earliest recollection is the Hawke Governments proposal to plant 1million trees back in the 80's.
2. There has been much talk about the need to encourage pine and other plantations as part of an international imperative to replace the massive reduction in forests and natural habitats contributing to increases in Co2 emissions including the deforestation of the Amazon. The UN reported in 1997 that almost half of the planet's original forests had been destroyed, mostly during the previous three decades and that during the 90's although the world gained 1.8 % of its natural forests through reforestation with plantations, afforestation and the natural expansion of forests, it lost 4.2% of its forests through deforestation- a net loss of 2.4%.
3. It was in this 'climate' of public awareness and concern that governments and individuals formed the view that governments have to intercede and encourage the establishment of new plantations.
4. The expected lowering of demand for paper products and consequently woodchips did not emerge with the computer revolution. Rather, the widespread business and consumer demand for software products and the relatively low cost of printers and photocopy paper led to an increasing demand for paper with the growth in print capability.
5. The federal government supported the MIS industry through the tax deductible write-off in year one of the investment. It had no other direct involvement.
6. The role of the Australian Taxation Office was to issue Product Rulings which generally stated that if the terms and conditions in the proposal were carried out, the investment in the project would be fully tax deductible in the year of investment.

7. Given the profile and government support for tree plantations, investors including lots of mums and dads invested in these MIS products with accountants bombarded by financial planners to get their clients to sign up with the attraction of fully funded finance by a related entity of the Scheme Promoter Company. The financial planners were contracted by the Scheme Promoter companies with the attraction of large commissions. This cost was additional to the cost of employed sales and marketing people coupled with visits by marketers and investors to the relevant MIS location to promote the products and support the financial planners .I personally received an all expenses flight paid for by Great Southern to visit the plantation in Albany, W.A. to visit the tree plantation forest (*I remember it well as it was the day that Kathy Freeman won the Gold medal in the 400 meters at the Sydney Olympic Games*) as well as (*in a different year*) a separate all expenses flight to King Island to visit the cattle farms.
8. The Chairman of ASIC Mr. Tony D'Aloisio on the 4th June 2009 explained that an estimated \$350 billion worth of investor's funds in MIS products involved a "high level of self regulation" and that while MIS products must be registered with ASIC and the responsible entity must be licensed, there was no assessment of the "merit" of the offer. Moreover, he declared that the 'the basic philosophy behind (*MIS regulation*), similar to a number of areas was to leave it to the market with oversight and market conduct supervision from ASIC. He further declared that ASIC's role is that they have functions of licensing RE's (*responsible entities*) and register the schemes and that they don't actually vet or approve them."We are monitoring on-going disclosure but there's no requirement that product disclosure statements be filed with ASIC" (*The Age, June 8, 2009*).
9. A Responsible Entity, Great Southern Managers Australia Limited (GSMAL) was supposed to with its (board majority) "independent Directors" represent and protect the investors by managing the scheme on behalf of the investors and be arms-length from the Scheme Promoter Company, Great Southern Plantations Ltd. It is the Scheme Promoter Company that appoints the RE-not an independent body and the RE's Directors included several of the same Directors in the Scheme Promoter Company.

The Players

There are a number of participants that impacted on the events that has led to the debacle and failure of these MIS companies like Great Southern and Timbercorp.

10. The following individuals/entities/groups are involved:-
 - a. The Scheme Promoter company
 - b. The Scheme Promoter company's Directors

- c. The Scheme Promoter company's Shareholders
- d. The Accountants and Auditors of the Scheme Promoters Company
- e. The finance company associated with the Scheme Promoter Company providing the funding for the Investors
- f. The Bankers who made loans to the Scheme Promoter Company
- g. The Responsible Entity (RE) allegedly representing investors
- h. The Directors of the RE
- i. The Accountants and Auditors of the RE
- j. The Financial Planners promoting the investments
- k. The Government and Parliament of the day
- l. The Australian Taxation Office
- m. The Australian Securities and Investment Commission

The Primary Responsibility for Capital Wastage

- 11. The primary responsibility for this debacle is in my submission a shared responsibility. However, I would hold as principals-the Government and Parliament of the Day and ASIC (*followed closely by the Directors of the Scheme Promoter Company and RE and their respective Auditors*).
- 12. It is important to recognize that Australians are broadly interested and connected to a greener Australia.
- 13. National Australian governments of various persuasions have been in unison over the last 25 years in publicly promoting and supporting tree planting as an important capital investment to fulfill this nation's desire for land preservation and ecology protection.
- 14. The easiest method of support by the Parliament for any MIS proposal is to provide a tax deduction. This method with respect is an inefficient and unsatisfactory method of spending our nation's capital and is in effect, an abrogation of Governments' responsibility to planned goals and achievable outcomes for this sector. In this regard, the method is painless as it is uncollected tax revenue that is foregone and in this sense, is an invisible 'capital investment'. The reality is however that Government is by definition, the biggest investor in all these MIS schemes.
- 15. A set and forget mentality would not be condoned in the business world as best practice for such a massive capital investment.
- 16. Worse still, the Commissioner of Taxation is then put in an impossible position to validate these MIS schemes arising from an obligation to issue product rulings that were inevitably used to ply the schemes by MIS marketing agents to true believers to substantiate the righteousness and commerciality of the investment. The Commissioner while not having any role in determining the commercial viability of the MIS is seen by the

investors as giving commercial efficacy by approving the MIS for tax purposes. In this regard, one of the criteria for the investor to obtain a tax deduction is that the MIS itself is indeed a commercial arrangement. This is vastly different to a determination that the MIS is a commercially viable undertaking. One can have a commercial operation that by its underlying assumptions for anticipated future revenue for example, is always going to make a loss, even though it is a 'commercial operation'. The problem is that the public cannot distinguish between a commercial operation and a commercially viable operation.

17. The public also do not appreciate that the Commissioner will ultimately determine the deductibility of the investment in respect of each taxpayer investor. Quite separate from a favourable product ruling, in accordance with Part IVA of the Income Tax Assessment Act 1936, as amended, the Commissioner can determine for each taxpayer on a case by case basis that the dominant purpose of the MIS was to receive a tax benefit and as a result, the claim may receive a ruling that the particular investment is not tax deductible.
18. As we can see from the Chairman's report above, ASIC (*also*) do not determine the merit of an MIS proposal nor vet or approve them. The public have no idea that ASIC is not a regulator at all and that at best, masquerades as a post office box.
19. In the case of ASIC and the Commissioner of Taxation, it must be Government that defines their respective roles and determine the scope and relevance of their involvement when it is seeking to propose and implement large scale managed investments. Currently, the phrase 'managed investments' is anything but a managed strategic investment in this nation's future. I believe that Government has a positive duty of care to the public and the investment community to ensure proper enforceable guidelines exist with an independent approval and monitoring process where, in particular, there is a desire to encourage specific capital investment in the environment through MIS schemes.
20. Specifically in relation to ASIC, if the Chairman is correct about the statutory responsibility of ASIC, then one must conclude that this lack of empowerment is a fundamental flaw in Parliament's prescription for the statutory role of ASIC.
21. One cannot help but observe that ASIC does not appear to have any operational or statutory impediment to exercise its powers after the event, including putting a freeze on assets of Directors and Third Parties or instituting proceedings for defrocking Directors and seeking court orders for penalties (*see for example James Hardie*). Why, one may well ask, does the Chairman view that the prime directive of ASIC is to exercise its powers to strongly intervene after a corporate catastrophe that is, as a sort of cure, rather

- than establish protocols and a charter for intervention to ensure its prevention and mitigate losses by investors?
22. On the 13th November 2008, I attended an investor and shareholder meeting/gathering in Melbourne where about 1000 people attended to hear the roadshow spiel of the Directors of Great Southern Plantations (*the Scheme Promoter company*) and GSMAL (*the RE*) to sell the proposal to investors and shareholders to swap their trees or/and cattle for shares in Great Southern.
 23. Prior to that meeting, I wrote to ASIC asking them to intervene and prevent this fraudulent misrepresentation by the RE directors and KPMG. A copy of my complaint dated the 3rd November 2008 is attached as Appendix A. I stated among other things that "I am very concerned that Great Southern is insolvent".
 24. ASIC issued on the 7th of November, 2008 an unsigned letter from their Misconduct and Breach Reporting, Stakeholder Services Branch said that the issues raised will receive careful consideration and put questions to a Nicholas Roper. On the 25th November 2008, Mr. Roper said that the issues I raised have been referred to another of ASIC and that ASIC is "unable to comment further" and that if ASIC had any requirement for further information from me, they would contact me directly. In effect, ASIC was saying don't call us we'll call you. No further contact has been forthcoming from ASIC to date. A copy of their response is attached as Appendix B.
 25. In my respectful submission, Mr. D'Aloisio should be requested to provide an explanation for this response and ASIC's failure to prevent this fraudulent proposal as against the investors when ASIC was warned about the fraudulent activity prior to its purportation.

The Secondary Responsibility for Capital Wastage and Profiteering

26. Prior to the meeting, I and Mr. Leon Sholl, solicitor and investor met with Mr Steven Cole Chairman of Directors of GSMAL (the RE) and Mr Duncan Calder, Partner Corporate Finance of KPMG. A copy of their business cards that were given to me are attached as Appendix C. Please note that Steven Cole gave me a private company card. I told them that the proposal was fundamentally flawed as:-
 - a. The investors would be taxed on the value of the shares as it was assessable income.
 - b. The investors would be required to repay loans as the underlying asset (*trees and cattle*) and therefore security for the loans would be converted to shares.

- c. That as a result of a and b, the investors would have to sell the shares to obtain cash and there was nothing that would underpin the share value.
 - d. That as a result in massive losses of share value, there would be diminishing returns to shareholders on the sale of their shares assuming there was a market for them and they were at all sellable.
 - e. The company would not be able to raise share capital with a falling share price.
 - f. Arising from the massive fall in share value, covenants that I suspected were linked to bank loans would be triggered and lenders of Great Southern would pull the plug on the company or/and by definition would make Great Southern insolvent.
 - g. That as a result, the valuation by Duncan (KPMG) of the shares which had already been devalued after the first attempt at this asset acquisition for shares in September 2008 is unequivocally flawed and unjustifiable on any truly independent valuation.
 - h. That if according to KPMG, the underlying asset value (*i.e enterprise value*) of Great Southern far exceeds the current share value, why not liquidate the land assets and pay out everyone at a profit?
 - i. The clear evidence was that the RE directors (GSMAL) should not be recommending anything that puts the investors in a worse position than they are or would be with their investment intact i.e. improperly recommending shares for real assets.
 - j. That the proposal was unsound and unsafe by their own admission as the recommendation by Mr.Cole for the RE to investors to accept the proposal was that it was the best proposal "in the absence of a superior proposal". The recommendation was not one that was formed on a view that it intrinsically represented real value to the investors. These words of 'in the absence of a superior proposal' were I said a phrase to confuse mum and dad investors. Moreover, I said that there was no evidence that he, as Chairman of Directors of the RE had sought another proposal from the investment community.
 - k. That all of this proves that the RE directors are not really arms-length from Great Southern.
27. These men were not able to respond to these significant points of irregularity and it was clear to me that they were going to proceed in the face of any opposition.

28. Mr Sholl and I attended the meeting and I spoke publicly stating the reasons why the assets for shares proposal was financially flawed. I also added that they could have asked a committee of investors to be formed and they could still do so and that I for one would be happy to serve at no charge to the investors.
29. It is my respectful submission that Mr Cole, Mr. Calder Mr Cameron Rhodes, Mr Young and all directors of the Scheme Promoter and RE entities should have their assets frozen and seized and that they should also be prosecuted for fraudulent conduct. In this regard, not only did they promote and participate in a scheme to trick investors to swap their assets for shares, they were warned not to do so by many investors and proceeded to do so in the face of those warnings.

Recommendations -Salvaging the MIS Schemes

30. The current fix-it regime is for the MIS Scheme companies to be placed in liquidation so that they may be further raped and pillaged by liquidators and lawyers while the courts are tied up for years with the liquidator seeking court approvals and class actions by enterprising law firms.
31. It is my submission that Parliament introduces retrospective and prospective laws -much as it did for the bottom of the harbour tax schemes to ensure that all monies are recoverable by investors and that shareholders get some return.
32. These measures could include the following:-
 - a. The Government take over the schemes and see them out including conversion of the pine forests to woodchip for sale and an orderly sale of landholdings.
 - b. The government to appoint an expert panel of businessmen who will form a board of management in an honorary capacity to direct an efficient operation for the government to implement appropriate measures until their completion in accordance with an effective business plan supported by legislation.
 - c. Legislate to make the investors preferential secured creditors before the banks/ secured land lenders (*who were also culpable as they gave loans to the Scheme company that put at risk the security of the investors*) followed by the shareholders and then the banks. Please note that the government receives tax revenue from the proceeds recovered by the investors as they are all tax.

- d. Make KPMG culpable for its fraudulent advice and recover the balance of the losses.
- e. Seize the cash held by the finance company that improperly sold the loans of investors to the Bendigo bank and others and refund the Bendigo bank and others reversing the transactions (*Debt ledger sales*).
- f. Legislate for a moratorium on loans owed by investors until the investors recoup their capital investment. No further interest is to be payable on the loans.

The Future

- 33. If we are serious in this country about promoting privately owned agri business that underpins or exists side by side with an eco/environment policy, Parliament should delegate the function of designing a planned role out to the business community.
- 34. A tender process could be established with an honorary committee of eminent persons charged with the responsibility of evaluation and selection.
- 35. I would see these proposals being partly funded by government and partly by investors through a not for profit Responsible entity overseen by an organization like ASIC with clearly defined accountable responsibilities and powers.
- 36. Government can recover its investment through taxes on distributions to investors.
- 37. In the end, Australia will benefit from an investment that will produce an efficient use of private and public capital supporting valuable Agri businesses.
- 38. It is vital that we rebuild confidence in the investment community into such projects as well as gain a sense of satisfaction that we are doing some good for future generations.

David Mond